



Article

# Transforming Geopolitical Risk: Public Diplomacy of Multinational Firms for Foreign Audiences

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## Abstract

This article addresses the strategies of multinational firms when faced with business risk arising from nationalist tensions and interstate conflict, focusing on the use of social engagement activities under the rubric of corporate social responsibility (CSR) that are targeted at the host country's society at large. The adoption of this strategy is contingent on firms' risk perception: firms with higher degrees of risk perception invest more resources in social strategies. Moreover, as firms are more exposed to risk over time, they shift their risk management strategies to ones that try to transform the nature of risk through private sector activities that resemble public diplomacy. The argument is tested quantitatively using unique data on the contributions of Japanese firms to social engagement activities in China, and qualitatively with descriptive statistics from surveys of CSR activities and elite interviews with state and business actors in China and Japan. The findings highlight new socio-political roles for multinational firms in international politics.

## Introduction

Business risk arising from international political conflict can present multinational firms with intractable problems. The host governments and societies of such firms hold them responsible not only for economic or business matters directly related to their operations, but also for the policies or behaviour of their home country. Australian citizens boycotted French wine in the 1990s to oppose France's nuclear tests in the Pacific,<sup>1</sup> and Americans

1 Peeter W. J. Verlegh and Jan-Benedict E. M. Steenkamp, 'A Review and Meta-Analysis of Country-of-origin Research', *Journal of Economic Psychology*, Vol. 20, No. 5 (1999), pp. 521–46.

did the same in 2003 to express their opposition to France's stance on Iraq.<sup>2</sup> In 2013, LGBT supporters ceased buying Russian vodkas to oppose Russia's policies on gay and lesbian rights.<sup>3</sup> Alongside violent protests and death threats directed against the artist, some Muslims in Arab countries boycotted and destroyed Danish products in condemnation of cartoons of the Prophet Muhammed published by the Danish newspaper *Jyllands-Posten* in 2005.<sup>4</sup> The ability to do business can sometimes become so toxic or dangerous that multinationals withdraw from a host country and their trade and investment there precipitously decline. In other circumstances, firms will manage to maintain business connections despite an adverse atmosphere. This article examines how multinationals manage the business risks arising from geopolitical tensions when withdrawal from a country is not the preferred option, using data from Japanese multinationals operating in mainland China.

The article analyses one strategy that firms adopt when faced with political risk arising from nationalist tensions and interstate conflict: the transformation of risk through social engagement activities, often conducted under the rubric of corporate social responsibility (CSR) activities. Social engagement activities include educational and cultural exchange programmes, much like the 'heart-to-heart' diplomacy, or soft power, wielded by states. The adoption of this risk management strategy is contingent on the degree to which firms experience risk: firms with higher exposure to political risks from host societies invest more resources in social strategies. They try to affect attitudinal changes in a foreign society that create a business environment more hospitable to their interests. In engaging in these activities, multinational firms also become political actors in new ways. They are not simply drivers of economic or fiscal policy, as predicted by theories of globalization and the state,<sup>5</sup> nor replacements for state governance over social service provision, environmental policy, or human rights, as in recent arguments about CSR and the role of the multinational corporation (MNC).<sup>6</sup> Rather, these firms are conducting informal public diplomacy, and even quasi-foreign policy, from their position as cross-border private sector actors.

While such firms are acting from a business-motivated rational self-interest perspective, their actions have the long-term potential to affect cross-border relations. Some of the CSR

- 2 Christina Davis and Sophie Meunier, 'Business as Usual? Economic Responses to Political Tensions', *American Journal of Political Science*, Vol. 55, No. 3 (2011), pp. 628–46.
- 3 Mark Lawrence Schrad, 'Boycotting Vodka Won't Help Russia's Gays', *New York Times*, 20 August, 2013.
- 4 Michael Kimmelman, 'Outrage at Cartoons Still Tests the Danes', *New York Times*, 20 March, 2008.
- 5 Vincent Cable, 'The Diminished Nation-state: A Study in the Loss of Economic Power', *Daedalus*, Vol. 124, No. 2 (1995), pp. 23–53; Susan Strange, 'The Defective State', *Daedalus*, Vol. 124, No. 2 (1995), pp. 55–74; Peter Evans, 'The Eclipse of the State? Reflections on Stateness in an Era of Globalization', *World Politics*, Vol. 50, No. 1 (1997), pp. 62–87; Sean O. Riain, 'States and Markets in an Era of Globalization', *Annual Review of Sociology*, Vol. 26 (2000), pp. 187–213. For more recent treatment of the politics of foreign direct investment, see Nathan M. Jensen, *Nation-states and the Multinational Corporation: A Political Economy of Foreign Direct Investment* (Princeton: Princeton University Press, 2008); Nathan Jensen, Glen Biglaiser, Quan Li and Edmund Malesky, *Politics and Foreign Direct Investment* (Ann Arbor: University of Michigan Press, 2012).
- 6 John Gerard Ruggie, *Just Business: Multinational Corporations and Human Rights* (New York: W. W. Norton & Company, 2013).

activities that MNCs conduct in host countries are efforts to change the social/political landscape wherein they do business. Building on business and marketing literature that describes the 'insurance-like' properties of CSR, I analyse not only philanthropic and environmental activities typically associated with CSR, but also firms' promotion more broadly in the host society of a firm's home culture. When conducted by the diplomatic corps, these activities are often labelled public diplomacy, or soft power, but in this case these activities are funded and implemented by the private sector. Firms invest resources in social and cultural activities with the goal of promoting favourable impressions of their home country, in efforts to ameliorate the consequences of operating in a hostile business environment.

All firms do not engage equally in CSR activities: CSR is costly, and not all firms are willing to invest their limited resources in activities that are not directly connected to their bottom line. Firms' experience of the aftermath of geopolitical tensions motivates them to pursue CSR activities not only to protect the interests of the individual firm, but also in attempts to alter the very business environment in which the firm operates. Firms that have a greater threat perception of political conflict risk engage in these more *socially transformative* or *country-promoting* activities than those that do not. This argument is tested with a multi-methods approach, utilizing qualitative narrative elite interviews<sup>7</sup> and a unique quantitative dataset created by the author.

The article proceeds as follows: the following section describes existing literature and theory on CSR, MNCs, and risk management, and builds three hypotheses of firm behaviour. 'Sino-Japanese Relations' section introduces the background of the primary case of Sino-Japanese relations and 'Japanese CSR Activities in China' section uses interview and survey data to look at the changing nature of CSR activities across time as political tensions have ebbed and flowed. This section demonstrates how the target CSR audience has shifted from efforts aimed at promoting the firm's individual reputation to those aimed at transforming how the host society interacts with an MNC's country of origin. 'The Japan Chamber of Commerce and Industry in Beijing's Cultural Exchange Programme' section analyses a large-scale educational exchange programme organized by the Japanese Chamber of Commerce in Beijing (JCCI) and funded by more than 100 Japanese companies in the wake of the 2005 wave in China of particularly intense anti-Japanese vitriol. I analyse the characteristics of contributing firms with an ordered logit model to demonstrate that a firm's exposure to political conflict risk is pivotal to their CSR strategy, and briefly evaluate the efficacy of the strategy. The final section concludes with a discussion of the transformational power of CSR.

## Multinational Firms, Risk, and CSR

Milton Friedman famously argued in the 1960s that companies should by no means engage in CSR because 'the social responsibility of business is to increase its profits', not to engage in unprofitable activities that bring no directly measurable benefit to its stakeholders.<sup>8</sup> Since then, a rich literature in the field of international business, as well as nascent global

7 A full description of interview methodology and anonymized descriptions of participants are available in Online [Supplementary Material](#), as well as in Kristin Vekasi, *China's Political Rise and Japan's Economic Risk: Multinational Corporations and Political Uncertainty*, PhD dissertation, The University of Wisconsin-Madison, 2014.

8 Milton Friedman, 'The Social Responsibility of Business is to Increase Its Profits', *New York Times Magazine*, 13 September, 1970.

norms promoted by international organizations such as the United Nations (UN), has ignited a debate over the benefits of CSR. Scholars of international business argue that CSR can be beneficial to firms as a form of insurance; CSR's reputational externalities can protect the firm in the event of crisis. Normative purveyors of CSR argue that firms ought to engage in CSR to be responsible international corporate citizens. This article presents an alternative role for CSR in international politics: that whereby MNCs instrumentally use CSR to try to mitigate risks arising from geopolitical tensions. This approach to CSR is not conceptually novel from the perspective of business literature: the notion that firms will proactively seek opportunities to improve their social reputation is well acknowledged.<sup>9</sup> This research, however, bridges international political economy and international business literatures on political risk and risk management and, examines *political* consequences of firms as social actors.

Firms use CSR strategically to enhance their individual legitimacy or reputation,<sup>10</sup> or to mitigate negative perceptions stemming from accusations of environmental damage,<sup>11</sup> abuse of workers' rights,<sup>12</sup> and corruption,<sup>13</sup> among other things. MNCs use CSR in host societies not only for these functions, but also as a political tool to try to shift popular opinion towards one that is more amenable to their own interests. Anti-foreign sentiment, especially after periods of bilateral political tensions, creates a high uncertainty environment and exposes foreign firms to additional risks. This conception of CSR differs from those rooted in the study of international governmental and non-governmental organizations, and emerging non-economic responsibilities of MNCs. Rather than conceptualizing MNC activity as a response to the emergent norms and pressures from international organizations, it focuses on the strategic behaviour of multinationals as they respond to international domestic pressures.

A norm of CSR in international business began to form in the early 1990s, in the United States and in Western European countries, as governments, social activists, and media outlets began to hold companies responsible for their actions in home countries and around the world.<sup>14</sup> Consumers held textile companies accountable for labour conditions in their

- 9 See Archie B. Carroll and Kareem M. Shabana, 'The Business Case for Corporate Social Responsibility: A Review of Concepts, Research and Practice', *International Journal of Management Reviews*, Vol. 12, No. 1 (2010), pp. 85–105; Michael L. Barnett and Robert M. Salomon, 'Does It Pay to Be Really Good? Addressing the Shape of the Relationship between Social and Financial Performance', *Strategic Management Journal*, Vol. 33, No. 11 (2012), pp. 1304–20.
- 10 Neil Mitchell, 'Corporate Power, Legitimacy, and Social Policy', *Western Political Quarterly*, Vol. 39, No. 2 (1986), pp. 197–212.
- 11 Michael J. Lenox and Charles E. Eesley, 'Private Environmental Activism and the Selection and Response of Firm Targets', *Journal of Economics & Management Strategy*, Vol. 18, No. 1 (2009), pp. 45–73.
- 12 Mark Anner, 'Corporate Social Responsibility and Freedom of Association Rights: The Precarious Quest for Legitimacy and Control in Global Supply Chains', *Politics & Society*, Vol. 40, No. 4 (2012), pp. 609–44.
- 13 Timothy Frye, 'Original Sin, Good Works, and Property Rights in Russia', *World Politics*, Vol. 58, No. 4 (2006), p. 479–504.
- 14 Lisbeth Segerlund, *Making Corporate Social Responsibility a Global Concern: Norm Construction in a Globalizing World* (London: Taylor & Francis, 2010).

overseas production facilities, pharmaceutical companies operating in Africa were pressured to become involved in HIV/AIDS issues, and organizations began publishing and widely publicizing annual measures of corporate citizenship.<sup>15</sup>

At the same time, CSR began to appear on the agendas of international organizations such as the World Bank, IMF, and UN.<sup>16</sup> The World Bank, for example, encourages developing countries to work with corporations to execute a policy of CSR activities as development work.<sup>17</sup> The UN urges businesses to promote human rights sensitive business practices, and to report to groups such as the Global Reporting Initiative, which collects reports on corporate sustainability. CSR is promoted by the UN via the Global Compact, an initiative launched in July 2000 that encourages multinational businesses to be good corporate citizens according to ‘universally accepted principles in the areas of human rights, labour, environment, and anti-corruption’.<sup>18</sup>

Political science and sociology research on CSR focuses on how NGOs have mobilized to exert pressure on multinational firms to change their global business practices.<sup>19</sup> Some NGOs partner with MNCs to plan and implement CSR measures, leading scholars to note a potential global ideational shift in what the role of the firm should be—an entity with

- 15 Michael E. Porter and Mark R. Kramer, ‘Strategy and Society: The Link Between Competitive Advantage and Corporate Social Responsibility’, *Harvard Business Review*, Vol. 23, No. 5 (2006), pp. 78–93.
- 16 Michael Blowfield, ‘Corporate Social Responsibility: The Failing Discipline and Why It Matters for International Relations’, *International Relations*, Vol. 19, No. 2 (2005), pp. 173–91; C. Christopher Baughn, John C. McIntosh, Nancy Bodie, ‘Corporate Social and Environmental Responsibility in Asian Countries and Other Geographical Regions’, *Corporate Social Responsibility and Environmental Management*, Vol. 14, No. 4 (2007), pp. 189–205; Andreas Georg Scherer and Guido Palazzo, ‘The New Political Role of Business in a Globalized World: A Review of a New Perspective on CSR and Its Implications for the Firm, Governance, and Democracy’, *Journal of Management Studies*, Vol. 48, No. 4 (2011), pp. 899–931; Steen Vallentin and David Murillo, ‘Governmentality and the Politics of CSR’, *Organization*, Vol. 19, No. 6 (2012), pp. 825–43.
- 17 Rhys Jenkins, ‘Globalization, Corporate Social Responsibility and Poverty’, *International Affairs*, Vol. 81, No. 3 (2005), pp. 525–40; Peter Utting, ‘Corporate Responsibility and the Movement of Business’, *Development in Practice*, Vol. 15, No. 3–4 (2005), pp. 375–88.
- 18 *Corporate Responsibility & The Global Compact 2013*. For a detailed description of the development and content of the UN Global Compact, see Ruggie, *Just Business*.
- 19 Chaime Marcuello Servos and Carmen Marcuello, ‘NGOs, Corporate Social Responsibility, and Social Accountability: Inditex Vs. Clean Clothes’, *Development in Practice*, Vol. 17, No. 3 (2007), pp. 393–403; Michele Micheletti and Dietlind Stolle, ‘Mobilizing Consumers to Take Responsibility for Global Social Justice’, *The Annals of the American Academy of Political and Social Science*, Vol. 611, No. 1 (2007), pp. 157–75; Brayden King and Mary-Hunter McDonnell, ‘Good Firms, Good Targets: The Relationship between Corporate Social Responsibility, Reputation, and Activist Targeting’, in Kiyoteru Tsutsui and Alwyn Lim, eds., *Corporate Social Responsibility in a Globalizing World: Toward Effective Global CSR Frameworks* (Cambridge: Cambridge University Press, 2015), pp. 430–454; Alwyn Lim and Kiyoteru Tsutsui, ‘Globalization and Commitment in Corporate Social Responsibility: Cross-National Analyses of Institutional and Political-Economy Effects’, *American Sociological Review*, Vol. 77, No. 1 (2012), pp. 69–98.

enlightened self-interest that contributes responsibly to the community rather than simply a profit maximizer—and the subsequent increase in CSR visibility as a consequence of that transformation.<sup>20</sup>

The change internationally in the expectations of multinational firms has led to a boom, if not in CSR activities themselves, at least in CSR reporting, and glossy annual corporate sustainability or corporate citizenship reports. Beyond the reputational concerns of not producing such a report, Porter and Kramer cite three additional corporate justifications for CSR: moral obligations to society, sustainability, and the licence to operate.<sup>21</sup> While moral obligations and sustainability speak to firms conforming to new social or environmental norms, the other two are more instrumental. ‘License to operate’ CSR seeks to deflect or defuse external pressure or conflict in the communities in which they operate. Firms similarly use reputational CSR to promote a positive image in hopes of guarding their financial interests in the event of a crisis.<sup>22</sup> This motivational split uncovers the critique that CSR is often no more than a cosmetic effort that businesses make to appease stakeholders without addressing more serious, structural issues as regards environmental, development, or labour problems, and hence illustrates the potential pitfalls of using CSR as a risk management tool.<sup>23</sup>

Nevertheless, scholars have found a positive correlation between CSR and successful crisis management. Godfrey builds a theory of the insurance-like qualities of CSR, wherein philanthropic activities can earn ‘moral capital, which provides the firm with insurance-like protection for its relationship-based intangible assets’, and generates goodwill towards a firm within society that shelters it from future risks.<sup>24</sup> In a later study of 160 American firms, Godfrey and co-authors found that CSR that is philanthropic in nature, or aimed at ‘society at large’, indeed had insurance-like properties after negative events such as lawsuits, whereas there was no such effect for firms that engaged in CSR activities targeted not

- 20 Gerald Davis, Marina Whitman and Nathan Zald Mayer, ‘The Responsibility Paradox: Multinational Firms and Global Corporate Social Responsibility’, *Ross School of Business Paper*, No. 1031 (2008); Segerlund, *Making Corporate Social Responsibility a Global Concern*.
- 21 Porter and Kramer, ‘Strategy and Society’, pp. 78–93.
- 22 Uwem E. Ite, ‘Multinationals and Corporate Social Responsibility in Developing Countries: A Case Study of Nigeria’, *Corporate Social Responsibility and Environmental Management*, Vol. 11, No. 1 (2004), pp. 1–11; Porter and Kramer, ‘Strategy and Society’, pp. 78–93; Manuela Weber, ‘The Business Case for Corporate Social Responsibility: A Company-level Measurement Approach for CSR’, *European Management Journal*, Vol. 26, No. 4 (2008), pp. 247–61; Jason Prno and D. Scott Slocombe, ‘Exploring the Origins of “Social License to Operate” in the Mining Sector: Perspectives from Governance and Sustainability Theories’, *Resources Policy*, Vol. 37, No. 3 (2012), pp. 346–57.
- 23 Jędrzej George Frynas, ‘The False Developmental Promise of Corporate Social Responsibility: Evidence from Multinational Oil Companies’, *International Affairs*, Vol. 81, No. 3 (2005), pp. 581–98; Subhabrata Bobby Banerjee, ‘Corporate Social Responsibility: The Good, the Bad and the Ugly’, *Critical Sociology*, Vol. 34, No. 1 (2008), pp. 51–79.
- 24 Paul C. Godfrey, ‘The Relationship Between Corporate Philanthropy and Shareholder Wealth: A Risk Management Perspective’, *Academy of Management Review*, Vol. 30, No. 4 (2005), p. 783.

at society but at shareholders (such as product relations or governance issues).<sup>25</sup> Frye's study of post-privatization business legitimacy in Russia found that a firm's use of CSR could improve its image, and that public goods provision could overcome the taint of illegitimacy firms had incurred from legal violations during the notoriously corrupt privatization process.<sup>26</sup>

For MNCs, the deep and rapid economic integration of the current era of globalization has complicated exactly what 'society-at-large', or audience, they are trying to inoculate themselves against. Godfrey and co-authors analyse the efforts of American firms to improve their reputations *vis-à-vis* local stakeholders (consumers, communities, or shareholders) and Frye similarly speaks to the possibility of Russian firms erasing the 'sin' of illegitimate property rights and avoiding legal suits within Russia. Concurrent with global economic integration, the idea of where and to whom corporations are responsible has shifted. Business scholars argue that, traditionally, companies were ' beholden to the communities in which they are located', but as firms have globalized so too has the audience (and the scope of responsibility) broadened. Today, 'people hold firms responsible for actions far beyond their traditional boundaries, including the actions of suppliers, distributors, alliance partners, and even sovereign nations'.<sup>27</sup> This onus of globalized responsibility is not only to home audiences and stakeholders, but also to foreign ones. Firms can be burdened with both their own faults and shortcomings, such as product quality or poor environmental practices, and the actions or policies of their country of origin. In turn, the role of reputation-enhancing activities, such as public goods provision or philanthropy, has by necessity expanded.

Which firms will choose to pursue CSR projects with the intent of attitudinal shifts in a host society—socially transformative CSR—and the timing of those projects depends on what risks the firm is trying to mitigate, the intended audience, and the market position of the firm within the host country. Patriotic activists, for example, target firms because of their identification with the foreign 'other'.<sup>28</sup> In the case of protest or targeting due to a firm's country of origin, firms thus need to protect themselves against that point of vulnerability: the intended audience is precisely those patriotic activists. CSR activities, however, are not uniform across all firms but rather contingent on a firm's particular experience with risks associated with country-of-origin bias and political tensions. CSR strategies thus vary based on the specific experiences and market goals of an MNC, including the degree to which it becomes a target within a host country, its dependence on the host country as a consumer market, and the political sensitivity of its sector.

Deteriorating or tense political relations between countries can affect MNCs directly. Resultant risks include rapid changes in foreign direct investment (FDI) policy or legal regulations by the host country, as well regime type, regime change, or shifts in fundamental

25 Paul C. Godfrey, Craig B. Merrill and Jared M. Hansen, 'The Responsibility Between Corporate Social Responsibility and Shareholder Value: An Empirical Test of the Risk Management Hypothesis', *Strategic Management Journal*, Vol. 30, No. 4 (2009), pp. 425–45.

26 Frye, 'Original Sin, Good Works, and Property Rights in Russia', p. 479.

27 Davis, Whitman and Mayer, 'The Responsibility Paradox', p. 32.

28 Hongmei Li, 'Marketing Japanese Products in the Context of Chinese Nationalism', *Critical Studies in Media Communication*, Vol. 26, No. 5 (2009), pp. 435–56; Karolina Mog-Sidor, 'Chinese-Japanese Relations in Consumer Perception and Consumer Behavior', PhD dissertation, Eberhard Karls Universität Tübingen, 2012.



economic policies like exchange rate or property rights regimes.<sup>29</sup> They also take the form of social uncertainties arising from ‘the beliefs, values, and attitudes of the population’.<sup>30</sup> Risks from social and political turmoil may sometimes be linked, although society will sometimes target a business directly, without using the government as an intermediary. Consumer boycotts, property destruction, or lost contracts are all potential threats to an MNC’s profit line,<sup>31</sup> as is uncoordinated discriminatory consumer behaviour, wherein a product is not purchased due to the nationality of the parent company.<sup>32</sup> When faced with these challenges, a company’s insurance strategy must respond to the origin of the risk: the host society. Although a host state may be instrumentally organizing protests, or using an international dispute to distract from domestic concerns, the MNC must nevertheless inoculate its business against the threats of losing local business partners, workers, or consumers due to xenophobia or targeted anti-foreign bias.

I argue that firms with an expectation of being targeted because of their country of origin will engage in ‘socially transformative CSR’, or CSR that specifically seeks to mitigate the effects of anti-foreign actions emanating from Chinese society, be they missed contracts, consumer boycotts, property violence, or large-scale demonstrations.

*Hypothesis 1: Firms that have higher risk exposure are more likely to invest resources in social transformation activities.*

- 29 K. D. Miller, ‘A Framework for Integrated Risk Management in International Business’, *Journal of International Business Studies*, Vol. 23, No. 2 (1992), pp. 311–31; Nathan Jensen, ‘Democratic Governance and Multinational Corporations: Political Regimes and Inflows of Foreign Direct Investment’, *International Organization*, Vol. 57, No. 3 (2003), pp. 587–616; Quan Li and Adam Resnick, ‘Reversal of Fortunes: Democratic Institutions and Foreign Direct Investment Inflows to Developing Countries’, *International Organization*, Vol. 57, No. 3 (2003), pp. 175–211; Krishna Chaitanya Vadlamannati, ‘Impact of Political Risk on FDI Revisited—An Aggregate Firm-Level Analysis’, *International Interactions*, Vol. 38, No. (2012), pp. 111–39.
- 30 Miller, ‘A Framework for Integrated Risk Management in International Business’, p. 315.
- 31 Stephen Robert Nagy, ‘Territorial Disputes, Trade and Diplomacy: Examining the Repercussions of the Sino-Japanese Territorial Dispute on Bilateral Trade’, *China Perspectives*, No. 4 (2013), pp. 49–57; R. Fisman, Y. Hamao and Y. Wang, ‘Nationalism and Economic Exchange: Evidence from Shocks to Sino-Japanese Relations’, *Review of Financial Studies*, Vol. 27, No. 9 (2014), pp. 2626–60; Vekasi, *China’s Political Rise and Japan’s Economic Risk*; see Davis and Meunier, ‘Business as Usual?’ for a discussion of conditions under which linkages between political tensions and macro-market behaviour are not realized.
- 32 Jill Gabrielle Klein, Richard Ettenson and Marlene D Morris, ‘The Animosity Model of Foreign Product Purchase: An Empirical Test in the People’s Republic of China’, *Journal of Marketing*, Vol. 62, No. 1 (1998), pp. 89–100; George Balabanis and Adamantios Diamantopoulos, ‘Domestic Country Bias, Country-of-origin Effects, and Consumer Ethnocentrism: A Multidimensional Unfolding Approach’, *Journal of the Academy of Marketing Science*, Vol. 32, No. 1 (2004), pp. 80–95; Lyn S. Amine, Mike C. H. Chao and Mark J. Arnold, ‘Exploring the Practical Effects of Country of Origin, Animosity, and Price-quality Issues: Two Case Studies of Taiwan and Acer in China’, *Journal of International Marketing*, Vol. 13, No. 2 (2005), pp. 114–50.



Firms that are direct targets of anti-foreign actions are more likely to seek to transform the social environment in which they do business. Social transformation CSR is thus related but distinct from proactive ‘activist appeasing’ CSR, which seeks either to appease socially conscious consumer activists or NGOs, or to deter such actors from targeting a firm by proactively building a positive corporate image.<sup>33</sup> The intended audience differs: activist-appeasing CSR largely seeks to mitigate damage from the critiques of home consumers or international NGOs, whereas the host society is the primary audience of socially transformative CSR. This distinction is important; the potential effects of CSR will be seen in the host country, rather than in the firm’s overall corporate performance or international reputation.

A firm’s business goals, and the extent to which it depends on local consumers to meet those goals, will also influence its CSR strategy. International marketing research indicates that animosity or strong emotion towards a foreign country leads to a negative bias against that country’s products.<sup>34</sup> Firms that have internationalized to market goods directly to local consumers, as well as take advantage of lower production costs or other benefits of a local market, therefore, should have greater risk exposure and thus a greater incentive to counter the effects of anti-foreign sentiments.

*Hypothesis 2: Firms trying to market products directly to local consumers are more likely to invest resources in social transformation activities.*

In the event of business repercussions from international political tensions, MNCs do have alternatives besides CSR activities. Indeed, socially transformative CSR should be seen as simply one risk management tool in a diverse box. Alternatives include appealing to local or national government officials, the local court system, or (if applicable and extant) using an investor–state dispute settlement mechanism if there has been breach of contract or other provable discriminatory behaviour. Firms can also choose to take no action and simply wait out the period of tensions. Finally, if the financial or safety consequences appear severe, fully or partially exiting the host market is another option. The first set of these risk management options engages directly with the state, not the host society. If an MNC’s primary investment goal is to capture consumer market share, then appealing to the state is unlikely to be a successful strategy *vis-à-vis* customers. If the MNC is in a politically sensitive sector or one related to national security concerns, then an appeal to the state rather than society is much more likely. I thus hypothesize that firms in these sectors will be less inclined to engage in socially transformative CSR.

*Hypothesis 3: Firms in politically sensitive sectors are less likely to invest resources in social transformation activities.*

As the contribution of the article lies in assessing more broadly the social transformation strategy, and not risk management strategies, the question of direct appeals to the state are

33 Lenox and Easley, ‘Private Environmental Activism and the Selection and Response of Firm Targets’; King and McDonnell, ‘Good Firms, Good Targets’.

34 Verlegh and Steenkamp, ‘A Review and Meta-analysis of Country-of-origin Research’, pp. 521–46; Amine, Chao and Arnold, ‘Exploring the Practical Effects of Country of Origin, Animosity, and Price-quality Issues’; Durairaj Maheswaran, ‘Country of Origin Effects: Consumer Perceptions of Japan in South East Asia’, Technical Report Working Paper N-006, Centre for Japan–US Business and Economic Studies, The Leonard N. Stern School of Business, New York University, 2006.

not addressed here, but left for future research. These three hypotheses are tested using data from Japanese MNCs in the People's Republic of China.

## Sino–Japanese Relations

The ‘cold politics hot economics’ phenomenon, where economic relations have flourished even as political relations sour, is a long-standing puzzle in Sino–Japanese relations.<sup>35</sup> The apparent delinking between economic and political relations in the world's second and third largest economies runs counter to research that suggests that poor political relations can dampen trade or investment. Indeed, it also runs counter to the stated fears and intentions of firm managers themselves that express doubt about their economic future in China. Scholars such as Davis and Meunier have used this case to demonstrate that the ‘resilience of economic interdependence to political crises creates a buffer zone of normal business interactions that dilute the harm from political tensions’.<sup>36</sup> Others, notably Fisman, Hamao, and Wang, found demonstrable effects of such tensions on economic indicators such as stock prices.<sup>37</sup> This study contributes to that broader discussion of political–economic interdependencies by looking closely at one strategy of the central actor: the multinational firm.

The situation of Japanese firms in China is naturally unique in its particular history, but is also broadly generalizable to (at the least) cases of FDI flows from the rich world to emerging markets wherein geopolitical relations between the host and home countries are complicated or tense. In particular, the Japan–China case is similar to situations where anti-foreign sentiment is an important aspect of national identity, such as post-colonial dyads or strongly anti-American states. The key variable is that firms are targeted because of their national identity, a phenomenon not unique to Japanese firms in China.

Animosity towards Japan, kept aflame with policies of the Chinese Communist Party and plentifully fuelled through the history of Imperial Japan's brutal conquest of China, at times creates a difficult business environment for Japanese multinationals in China. Japanese products are boycotted by patriotic Chinese activists, high-profile Japanese products and stores are subjected to property damage, and the ability to conduct business as

35 Throughout the 2000s, Japanese businesses were consistently sanguine about economic prospects in China—an attitude reflected in consistently rising trade and investment numbers. Since 2013, trade and investment have contracted somewhat, leading some to wonder if the economic relationship is cooling and if the cold politics, hot economics era may be ended. For example, from 1989 to 2013 China was consistently named the most promising destination in JBIC's Annual Report on Overseas Business Operations by Japanese Manufacturing Companies, but fell to number 4 in 2013, losing out to Indonesia, India, and Thailand. For a detailed description of the cold politics, hot economics relationship, see Vekasi, *China's Political Rise and Japan's Economic Risk*; Yanming Li, *Nicchuu kankei to nihon keizaikai: kokkou seijoukakara “seirei keinetsu” (Japan–China Relations and the Japanese Business Community: From Normalization to “Cold Politics, Hot Economics”)* (Tokyo: Keiso Shobo, 2015).

36 Davis and Meunier, ‘Business as Usual?’, p. 644.

37 Fisman, Hamao and Wang, ‘Nationalism and Economic Exchange’.

usual is eroded as meetings and contracts are cancelled, and companies worry about the safety of their dispatched employees. After a particularly tense period in 2005, one analyst commented: ‘Sino-Japanese relations are described as “cold politics, hot economics” but, so long as the national mood of the Chinese people exists as a “latent risk”, there is fear that the economic relationship may also cool.’<sup>38</sup> The intertwining of business and politics in Sino-Japanese relations is nothing new: the May Fourth movement, which was a response to Japan’s territorial gains from the Treaty of Versailles, and a vital historical moment for social movements in modern China, included boycotts of Japanese corporations in China that are still noted by business consultants and China watchers. This historical legacy, which set a precedent for explicit and potentially violent linkages between politics and economics, is disturbing for firms seeking to keep their economic activities clear of the political realm.

In the 1960s, politics and economics were explicitly linked in the Sino-Japanese economic relationship through memorandum trade, wherein Japanese firms trading with China had to agree to three principles, among them the principle of the inseparability of politics and economics.<sup>39</sup> Despite political obstacles, trade in the Mao era was driven *in part* by the strong pro-China feelings of private Japanese actors: ‘their pro-China feelings were deep-rooted and genuine’, and arose from a belief in ‘Asianism’, personal experiences in China before or after the war, or even a sense of guilt about Japan’s behaviour during the war.<sup>40</sup> In interviews, economic actors from this time also mentioned the economic benefits of having a near-monopoly in the fertilizer trade as a driving motivation. Throughout the 1970s, and then after the normalization of Sino-Japanese relations, business groups such as the Japan-China Economic Association and political groups such as the Dietmembers’ League for the Promotion of Relations with China worked to promote Sino-Japanese economic interdependence in the face of political risks.<sup>41</sup> This time was known as the Era of Peace and Friendship, and historical memory and territorial conflicts were minimized in favour of mutual economic gains and Japanese aid.

After the reform and opening period began in the late 1970s, issues of past war atrocities began to play a more prominent role in Sino-Japanese relations. China’s reform and opening up era necessitated a transformation of nationalism, or ideological reform, which could bridge the contradictions between the revolutionary ideology of communism and market reforms. Deng Xiaoping and the Chinese Communist Party (CCP) reformers turned to China’s past history of national shame at the hands of foreign imperialists and the national glory of China’s long history to redefine the role of China’s past in state-society relations.<sup>42</sup>

38 Eimi Sato, ‘Chuugokushouhisha no Nihon kigyouseimeiji’ (‘Chinese Consumers’ Images of Japanese Firms’), *Ekonomisuto*, Vol. 83, No. 5 (2005), p. 127.

39 At the time, the politics largely referred to relations with Taiwan. See Yoshihide Soeya, *Japan’s Economic Diplomacy with China, 1945–1978* (Oxford: Clarendon Press, 1998). Large general trading companies like Itochu or Mitsui had ‘dummy companies’ so they could safely operate in both markets and disguise their violation of the three principles.

40 Soeya, *Japan’s Economic Diplomacy with China*, p. 15; Author interviews 36 and 69.

41 See Sheila Smith, *Intimate Rivals: Japanese Domestic Politics and a Rising China* (New York: Columbia University Press, 2015), chapter 3.

42 Zheng Wang, *Never Forget National Humiliation: Historical Memory in Chinese Politics and Foreign Relations* (New York: Columbia University Press, 2012).

The 1980s unleashed a torrent of anti-Japanese sentiment. Parents began to tell their children of suffering at the hands of the Japanese Imperial Army. The official narrative on Japan, which had been largely silent on the past, was rewritten to bring the past into present narratives.<sup>43</sup> Concurrent with the rewriting of national narratives, China 'opened up' to foreign trade and investment, bringing the ideology of anti-Japanese struggle into conflict with the official welcome and market access to Japanese firms.

After the 1989 Tiananmen Incident, the Chinese Communist Party needed to reforge its sources of popular power, and in the 1990s began a series of educational propaganda programmes in the form of patriotic education campaigns. The educational campaigns stressed China's unique national condition, and the 'need to remember earlier suffering at the hands of the West and Japan to prevent the loss of Chinese identity through foreign cultural and political intrusions, and to accept the need for strong government controls over society'.<sup>44</sup> An official, state-led, nationwide campaign began to retell the history of China's 'century of humiliation', in particular the Chinese People's War Against Japanese Aggression (the Second Sino-Japanese War), through museums and other popular venues,<sup>45</sup> and more recently in national holidays that celebrate victory against Japan and memorialize the victims of Japanese aggression.<sup>46</sup> As a result there was a dramatic resurgence of an anti-foreign sentiment, in particular anti-Japanese sentiment, both in the official discourse of nationalism and popular intellectual and online discourse.<sup>47</sup> There is much debate among observers of Chinese politics as to the extent to which anti-Japanese activity is organic versus the product of instrumental state-led mobilization, an issue addressed and debated extensively in the Sino-Japanese relations literature, particularly as the era of 'cold politics, hot economics' began in the 2000s.<sup>48</sup>

- 43 Edward Friedman, 'Raising Sheep on Wolf Milk: The Politics and Dangers of Misremembering the Past in China', *Totalitarian Movements and Political Religions*, Vol. 9, No. 2-3 (2008), pp. 389-409.
- 44 Suisheng Zhao, *A Nation-State by Construction: Dynamics of Modern Chinese Nationalism* (Stanford: Stanford University Press, 2004), p. 245.
- 45 Edward Friedman, 'Reconstructing China's National Identity: A Southern Alternative to Mao-Era Anti-Imperialism Nationalism', *Journal of Asian Studies*, Vol. 53, No. 1 (1994), pp. 67-91; Arthur Waldron, 'China's New Remembering of World War II: The Case of Zhang Zizhong', *Modern Asian Studies*, Vol. 30, No. 4 (1996), pp. 945-78; Rana Mitter, 'Behind the Scenes at the Museum: Nationalism, History, and Memory in the Beijing War of Resistance Museum, 1987-1997', *China Quarterly*, Vol. 161 (2000), pp. 279-93; Zhao, *A Nation-State by Construction*; Wang, *Never Forget National Humiliation*.
- 46 Carol Gluck, Rana Mitter and Charles K. Armstrong, 'The Seventieth Anniversary of World War II's End in Asia: Three Perspectives', *Journal of Asian Studies*, Vol. 74, No. 3 (2015), pp. 531-7.
- 47 Erica Strecker Downs and Phillip C. Saunders, 'Legitimacy and the Limits of Nationalism: China and the Diaoyu Islands', *International Security*, Vol. 23, No. 3 (1998), pp. 114-46; Zhao, *A Nation-State by Construction*; Susan L. Shirk, *China: Fragile Superpower* (Oxford: Oxford University Press, 2007); Wang, *Never Forget National Humiliation*; Jessica Chen Weiss, *Powerful Patriots: Nationalist Protest in China's Foreign Relations* (Oxford: Oxford University Press, 2014).
- 48 Peter Hays Gries, 'Chinese Nationalism: Challenging the State?' *Current History*, Volume 104, Number 683 (September 2005): pp. 251-256; Ming Wan, *Sino-Japanese Relations*:

The 2000s saw the results of growing anti-Japanese sentiment, as patriotic Chinese reacted forcefully and sometimes violently to statements by Japanese public figures denying past aggression, visits by Japanese officials to the Yasukuni Shrine, events related to Japan and China's territorial disputes, the anniversary of the Nanjing Massacre or Mukden Incident, a firm's advertising or public relations practices viewed as unfair to or critical of Chinese, or even Japan's victory over Team China in a soccer match. These events activated strong pro-China and anti-Japanese feelings, and triggered episodic anti-Japanese demonstrations that left business people concerned for their physical safety, consumer boycotts, property damage, and more. Anti-Japanese protests are usually exogenous to the actions of Japanese multinationals, but nonetheless directly affect them. The ideational shifts in China's political rise have thus created economic risks for Japanese market actors—they must respond to as political, even social, actors in order to protect their bottom line.

### Japanese CSR Activities in China

The Japanese business community—private and quasi-governmental business organizations, trade groups, industrial associations, and above all individual firms—maintains economic exchange in China through political risk management, or actions taken before or after political conflict that transform or hedge against the disruptions caused by political issues largely beyond their control. Japanese corporate China strategists, investment consultants to Japanese multinationals, and Japanese with long China business experience consistently tout CSR activities in China as the most effective method of risk management in the face of political tensions and anti-Japanese sentiment. 'We can't avoid China risk',<sup>49</sup> a China strategist in the Beijing office of a large Japanese multinational told me. 'But the firm needs to integrate into Chinese society in a positive way through social contributions to avoid worst-case scenarios.'<sup>50</sup>

A particular target of Japanese CSR is anti-Japanese sentiment, although this 'target' takes sophisticated aim, and is not simple to hit. The goals for CSR are two-fold: minimizing chances that their particular firm will be a target in a current or future demonstration, and transforming Chinese attitudes towards Japan in a more fundamental way such that the future market will be a more secure place for Japanese firms. Importantly, the intended audience for the CSR projects is not top officials within the CCP but rather Chinese society at large. This section describes the motivations behind social transformation activities in China, based on author interviews with consultants, government officials, and firms.

### Motivation

CSR sprang into public debate in the 1990s in Japan, but was not frequently discussed with reference to China until the late 1990s.<sup>51</sup> Japan's largest business organization, Keidanren

*Interaction, Logic, and Transformation* (Stanford: Stanford University Press, 2006); Shirk, *China*; Weiss, *Powerful Patriots*.

49 'China risk' is a synonym for China country risk, and in Japan particularly means the risks specific to Japanese companies arising from geopolitical conflict.

50 Author interview 73.

51 CSR activities in Japan have lagged behind those in the United States and Western Europe. See Kanji Tanimoto, 'Structural Change in Corporate Society and CSR in Japan', in Kyoko Fukukawa, ed., *Corporate Social Responsibility in Asia* (London: Routledge, 2009), pp. 45–66.

(the Japan Business Federation), first published a policy statement on CSR in 1991, soon after the bursting of the housing bubble had greatly damaged public perceptions of firms. It emphasized the need for firms to ‘seek trust from citizens and also the establishment of international businesses’ through philanthropic contributions, environmental protection, and socially responsible behaviour.<sup>52</sup> A review of Japanese books on risk management in China published between 1993 and 2011 reveals little discussion of CSR throughout the 1990s,<sup>53</sup> but an increasing focus starting in the 2000s.<sup>54</sup> Officials and official publications from the Japan External Trade Organization, a government-funded organization that facilitates Japanese investment abroad, actively push CSR as an appropriate risk management technique.<sup>55</sup>

A consultant with ties to Keidanren emphasized the need for Japanese firms in China to practice ‘public diplomacy’, or activities such as educational and cultural exchanges that promoted Japan. He likened firm activities to public diplomacy efforts conducted by the Japanese state. Firms, he emphasized, succeeded where the state failed because of their emphasis on ‘Japan’s contemporary cultural and technological achievements as opposed to traditional culture like wood-block prints’.<sup>56</sup> A risk management consultant vehemently rejected a role for the state, arguing that the private sector could better accomplish public diplomacy and in fact had a responsibility to do so. While this perspective was partially ideological (this respondent had libertarian leanings), it also reflected his belief that ‘social contributions to Chinese society were necessary to counter anti-Japanese sentiment’.<sup>57</sup>

Risk and investment consultants, Japanese and non-Japanese, based both in Japan and China, recommend social engagement activities as a risk management tool. After the anti-Japanese demonstrations in Spring 2005, China risk management specialist Takahara Sanjiro wrote in the *Nikkei Sangyou Shimbun* that Japanese firms need to ‘become a Chinese firm that achieves social responsibility’, or in other words, to successfully localize through gaining a responsible *Chinese* (rather than Japanese) public image.<sup>58</sup> A Japanese consultant at a private overseas employment firm echoed the concerns about Japanese firms’ ‘image problem’ in China, which he observed could exacerbate economic problems like labour or contract disputes. He similarly suggested that firms should improve their

52 Keidanren, ‘Keidanren Firm Activities Charter’.

53 Keizou Koga, *Chuugokubijinesu no jissai to shinshutsu no tetsuzuki—jimaiejunbi, chousa, tetsuzukikaratoraburuyobounado made* (Actual Conditions of Chinese Business and Procedures for Advancing into China—from Preparations, Studies, Procedures, to Trouble Prevention etc.), 1994; Toshiaki Sugita, *Chuugokubijinesu no risukumanejimento—shippai-karanarabuchokusetsutoushisenryaku* (Managing China Business Risks - Learning Direct Investment Strategies from Failures)(Tokyo: Diamond Company, 1996).

54 Nihon Sougou Kenkyuujo, *Chuushoukigyou no tameno Chuugoku jigyouisukukanri handobukku* (Handbook on China Risk Management for Small and Medium Sized Firms)(Tokyo: Chuushoukigyokubanseibikikou, 2010).

55 JETRO, *Chuugokubijinesu no risukumanejimento* (Managing China Business Risks)(Tokyo: Japan External Trade Organization, 2006), pp. 21–4.

56 Author interview 27.

57 Author interview 59.

58 Sanjiro Takahara, ‘Hannichi demo to risukumanejimento’ (‘Anti-Japanese Demonstrations and Risk Management’), *Nikkei Sangyou Shinbun*, 21 April, 2005.

image through philanthropic activities that could serve as a shield or deflect attention should an anti-Japanese incident arise.<sup>59</sup>

A Chinese consultant based at a large Tokyo think tank emphasized the need for firms to take a long-term perspective rather than focusing on specific instances of political conflict. He emphasized that social contributions to local society were ‘the most important strategy for firms trying to counter anti-Japanese sentiment because they addressed the overall problem rather than treating one small symptom’. Social contributions, in the form of philanthropic donations or cultural activities, improve the image of Japanese firms and would ‘enable them to form more effective alliances with local partners and attract a more talented workforce’.<sup>60</sup> A private Japanese tax consultant to foreign businesses in China pointed to successful cases of political risk management by firms that managed to persist in the China market despite being targeted by anti-Japanese protests or having production disrupted by social unrest. The firms he lauded, Matsushita Denki and Ito Yokado, both have pursued broad CSR campaigns.<sup>61</sup> Among other projects (and contributions to the exchange programme analysed below), Ito Yokado sponsors Japanese language education and a speech contest. Matsushita Denki provides scholarships to college students, and sponsors a Japan–China ping-pong tournament.

Two Japanese officials at an organization dedicated to promoting Japanese investment in China strongly emphasized the importance of building positive relationships. The head of the organization, having come to the position with a background as an Asia strategist for a large Japanese automobile company, said that the history problem was, and has been for Japanese firms since the normalization of relations in 1972, ‘the constant undercurrent of political risk in China’. Political risks could present problems for Japanese firms because they are ‘unpredictable, have root causes outside the capability of firms to control, and an overestimation of the degree of danger in China’. To counter these dangers, in particular that of uncertainty, these officials recommend that firms develop long-term relationships with Chinese business partners and local governments, and above all ‘respond to crises calmly (*reisei*)’.<sup>62</sup> A former official from the same organization (now a private consultant) saw CSR as the ‘obviously essential (*atarimae*)’ component of China political risk management. For large, iconic firms, CSR activities are a particularly essential part of a successful long-term China plan. The firms invest in such activities to establish a good ‘image’ in China, as well as to establish the firm as a more local entity and embed themselves in Chinese society.<sup>63</sup>

The Chinese founder of a non-profit organization founded to promote Sino–Japanese economic exchange emphasized the ‘importance of inter-personal exchange and communication’ to overcome economic issues stemming from nationalism and anti-Japanese sentiments. He advocated technological and educational exchange programmes, and cultural exchanges not directly related to an economic bottom line as ideal activities for firms to pursue in order to mitigate political risk and improve the business environment.<sup>64</sup>

59 Author interview 40.

60 Author interview 48.

61 Author interview 45.

62 Author interviews 36, 42.

63 Author interview 43.

64 Author interview 41.



For CSR activities to succeed as risk management the firm must, in addition to funding and implementing them, also inform direct beneficiaries and the general public that it is the responsible party. Many Japanese investment consultants are critical of their clients for being insufficiently visible in their CSR efforts.<sup>65</sup> Although firms purportedly do contribute to the societies in which they do business, they rarely publicize their efforts and hence receive no credit for them. Reticence about publicizing CSR activities is often attributed to a Japanese cultural taboo that prohibits saying positive things about oneself. For example, after an oil spill in Dalian harbour a large Japanese company with longstanding business ties in Dalian gave the city government the equipment and technology needed to clean it up. The city government offered to pay the company, but it refused, saying that it was the company's responsibility as a member of the community and that as such it would be a beneficiary. The city government then said it would publicize the company's assistance through press releases, news stories, etc. The company demurred, repeatedly exhorting the city government not to publicize the donations, explaining that this would negate its intention solely to be an upstanding member of the community.<sup>66</sup> After the Sichuan earthquake, there was a reportedly similar dynamic. Japanese enterprises gave charitable donations but received little public credit because they did not publicize their efforts.<sup>67</sup>

The lack of self-promotion is potentially also attributable in part to Japanese firms' lack of localization, or partnership with Chinese managers and local officials. If a firm can successfully partner with the local Chinese government, the local media will publish stories on the event or contributions to it, appropriately publicizing the firm by publishing its name in the local newspaper without giving the impression that the firm is trying to placate groups that would otherwise be in opposition to it.<sup>68</sup> Firms take care not to offend anybody, or to give the impression that social contributions are being used instrumentally. People in charge of a firm's CSR activities and the Japanese officials with whom they sometimes collaborate are most cautious, as they believe that 'one small (anti-Japanese) spark could start an (anti-Japanese) wildfire'.<sup>69</sup> This factor adds additional appeal to social transformation CSR, which promotes not the firm but the firm's home society.

### Types of Activities

Firms engage in various activities under the CSR umbrella, including charitable donations, environmental projects, and technical training programmes, as well as the social and cultural exchange programmes touted by firms and consultants as having potential long-term efficacy against political conflict risk. The *Survey Report of Japanese Corporate Social Contribution Activities in China*, conducted jointly by the Japanese Chamber of Commerce and Industry and the Japan Foundation (part of the Ministry of Foreign Affairs) in 2005 and 2009, provides an overview of CSR activities pursued by Japanese firms in China.

The survey's origins are somewhat unusual, and directly pertinent to this study. In the Spring of 2005, as anti-Japanese riots, sparked by opposition to Japan's bid for a seat on

65 Author interviews 26, 31, 33, 40, 42, 43, 45, 48, 50, 53, 54, 56.

66 Author interview 31.

67 Author interview 82.

68 Porter and Kramer, 'Strategy and Society', pp. 78–93.

69 Quote from author interview 16; Similar sentiments expressed in author interviews 7, 11, 17, 27, 53, 65; see also Kenkyuujō, *Handbook on China Risk Management for Small and Medium Sized Firms*.

the UN Security Council and other dimensions of the Sino–Japanese history problem, spread from city to city, a group of Japanese business and political leaders met informally in Beijing to debate on how to improve Sino–Japanese relations. Present at the meeting were Japanese officials from large ‘national-champion status’ Japanese corporations, bureaucrats from the Ministry of Foreign Affairs and Japan Foundation, and representatives from the Japanese Chamber of Commerce. Attendees of the meeting agreed that the current state of affairs was untenable for business, and that it was necessary to try to transform Chinese opinion of Japan from the ground up. A suggested first step (ultimately rejected due to cost) was to rebuild the Japan–China Friendship Hospital in Beijing; meeting attendees believed that this visible sign of goodwill between the countries would conjure positive images of Japan rather than memories of past militarism and atrocities.

This meeting eventually resulted in two alternatives to the hospital: a CSR survey, used in this study, and a biannual educational exchange programme run by the Chamber of Commerce.<sup>70</sup> The Ministry of Foreign Affairs initially opposed funding the survey, as it used public funding to publicize private sector activities. The promoters, however, successfully argued that CSR activities are, in essence, a form of cultural exchange necessary for greasing the wheels of political or economic exchange, and so secured the funding.

The survey covers a total of 287 cases in 2005 and 298 in 2009. Each case is a single CSR activity; consequently some firms are represented only once in the survey and others multiple times. In the 2005 survey, of the 559 firms surveyed, 74 reported conducting CSR activities and in 2009, 106 of the 388 firms surveyed responded affirmatively (response rates of 13.0 and 27.3%, respectively). A list of the negative cases—responding firms that did not conduct CSR activities—is unfortunately not available but, as described below, the sample is more broadly representative of Japanese FDI in China. Seventy-two cases were also excluded from the analysis because the firms were based solely in Hong Kong. Ultimately, this analysis includes 245 (from 2005) and 268 (from 2009) unique cases of CSR. The projects come from at least 24 provinces, municipalities, or autonomous regions.<sup>71</sup> Approximately 35% of the projects were based in Beijing, 14% in Shanghai, around 7% each in Tianjin, Guangdong, Liaoning, and Jiangsu, and less than 2% in other regions, reflecting a primary focus on China’s capital and major financial city, and a secondary one on locations with most Japanese investment.<sup>72</sup> The contributing firms are also representative of overall investment in China by sector, dominated by manufacturing, transportation, machinery, and trading companies.<sup>73</sup>

Survey results included short, paragraph-length descriptions of each project, which I used to code for different types of CSR. [Table 1](#) describes the broad contents of each type of CSR, and the proportion of each type in the 2005 and 2009 samples. They are grouped into three

70 Author interviews 30, 75, 119.

71 Some projects were simply labelled ‘all China’ or ‘various regions’, but at least 24 specific areas were identified.

72 According to the Ministry of Commerce’s Statistics on Foreign Capital, this makes Beijing and Shanghai somewhat over-represented in the sample, and other regions proportional to the amount of Japanese FDI received.

73 The sample includes 42% manufacturing, 8.5% machinery, 8.9% transportation, and 16% trading companies versus 46.9, 6.57, and 11.1% in Japanese FDI generally according to the Ministry of Commerce. Of the survey, 17% are trading companies, which bridge multiple sectors. Other categories are under 2% each in both samples.

**Table 1.** Types of CSR Projects

Type of CSR	Description	2005	2009
<b>Firm-promoting</b>		168 (69%)	149 (56%)
Welfare	Philanthropic donations including disaster relief, monetary donations to health programs, etc.		
Education	Building schools or providing scholarships for young children unable to attend school		
Community outreach	Activities undertaken in the same community as the factory or office to improve local relations or company image including cleaning trash around the company, organizing local sporting events, participating in local festivals, planting trees, etc.		
<b>Country-promoting</b>		39 (16%)	74 (28%)
Cultural exchange	Promoting Japanese culture in China or Chinese culture in Japan through bilateral exchanges, festivals, concerts, art exhibits, Japanese language education, etc.		
Educational exchange	Bringing Japanese students to China or Chinese students to Japan for educational, training, or cultural exchanges, such as study abroad, home-stay programs, company visits, international conferences, etc.		
<b>Technical</b>		38 (16%)	45 (17%)
Technical training	Company or industry specific training for Chinese workers or students (held in China or Japan) organized by a company but not a work program		
Environment	Corporate measures taken for environmental protection or promotion including environmental cooperation with local authorities, technical environmental assistance, etc.		
Total		245	268

broad categories: *firm-promoting* CSR, *country-promoting* CSR, and *technical* CSR that utilizes a firm's expertise for industry-specific training or environmentally clean technology.

Firm-promoting CSR, including welfare projects, education, and community outreach, made up 69% of all CSR in 2005, and 57% of all projects in the 2009 sample. This category includes activities such as sporting events, tree planting, or building 'hope schools' (elementary schools in poor rural areas), and largely targets the direct community within which a firm operates. For example, Omron, a medical equipment manufacturer, operates large production facilities in Dalian and has built hope schools in impoverished areas within Liaoning Province.

An exception to the geographically local component of firm-promoting CSR is that of philanthropic donations divorced from a firm's location or business plan, such as those made by Japanese firms to victims of the 2008 Sichuan earthquake, and contributions

towards combating the 2003 SARS outbreak. Earthquake relief specifically represented 44 cases (16.8%) in the 2009 survey. Donating firms did not have production facilities or offices located in the affected areas, but in addition to being a sincere humanitarian response to a terrible tragedy, the donations were also an endeavour towards goodwill economic diplomacy, Beijing having rebuffed the initial state-to-state cooperation efforts (the dispatch of the Japanese Self-Defence Forces (SDF)), even though the assistance and technical expertise of Japanese post-disaster relief teams was much desired on the ground in Sichuan.<sup>74</sup> Although official aid from the National Police Agency, the Japan Coast Guard, the Fire and Disaster Management Agency, and the Japan International Cooperation Agency (but not the SDF) was eventually accepted, these private donations were seen as a huge step towards repairing relations after the 2005 nadir.<sup>75</sup> If these cases are added to country-promoting social transformation CSR, there would then appear to have been a much larger reduction in firm-promoting activities. However, because the Sichuan earthquake was a one-off event without any cultural or social exchange elements, they are more appropriately categorized as firm-promoting CSR.

While widespread media attention or government approbation of a firm's efforts may achieve for the firm a larger public relations effect, these CSR activities directly assist only a small cross-section of people, usually in the immediate vicinity of the firm's production facilities. Approximately one-third of these projects consist in building hope schools or providing scholarships for elementary age schoolchildren whose families cannot afford to pay for their education. Generally geographically close to a production facility, such schools are designed to promote goodwill towards the firm. Tree-planting activities are also common, occurring close to a production facility with some fanfare over the course of a weekend, on sites to which employees travel and mingle with locals.<sup>76</sup>

Country-promoting CSR includes cultural or educational exchange programmes and cultural promotion programmes, designed to promote Japan as a nation rather than a firm's individual reputation. This category also includes philanthropic activities that do not target populations directly related to the firm, but rather generally promote the idea of Japanese amity towards China. Country-promoting activities accounted for 16% of total cases in 2005, and 28% in 2009. This type of CSR includes large-scale, highly visible events sponsored solely by Japanese corporations in order to bring the two countries closer together. For example, Aeon (owner of hypermarket Jusco) has a programme where 100 high school students take part in home-stay exchanges in Japan every year. The Japan Chamber of Commerce and Industry programme, discussed in depth below, entails biannual visits to Japan of more than 100 Chinese college students. Other activities include anime exhibitions and large rock concerts featuring J-pop idols. On a larger scale than hope schools or tree planting, these exchange efforts are often highly publicized, gala-like events. Social transformation CSR projects tend to target elite social groups such as university students.<sup>77</sup>

74 Hiroyuki Sugiyama, 'China Doffs Cap over Japan Aid: Beijing's Acceptance of Tokyo's Help Has Implications beyond Quake-aid Efforts', *The Daily Yomiuri*, 17 May, 2008.

75 Toshu Noguchi, 'Mixed Feelings among People's Liberation Army over Sichuan Earthquake: "Japanese Troops Should Just Go Home"' *SankeiShimbun*, 19 May, 2008; Nihon Keizai Shinbun, 'Jietaiki "kangeidekine" Chuugokugunkoukan, hannichikanjoujiyuuniShisendaijishin', *Nihon Keizai Shinbun*, Morning Edition 2, 1 June, 2008.

76 Author interviews 78, 79.

77 Author interviews 35, 123.

Both firm- and country-promoting CSR, abundant in the Chinese case at around 85% of both samples, target Chinese society at large, but in different ways. They try to capture the ‘hearts and minds’ of Chinese in efforts to inoculate against different forms of risk. Firm-promoting CSR protects the firm in the event of negative incidents in a particular area, such as a chemical spills, legal action against a firm, or labour disputes.<sup>78</sup> Country-promoting CSR has more macro designs; it attempts to disarm popular backlashes triggered by bilateral political tensions.<sup>79</sup> Educational exchange programmes or cross-cultural promotion events are common forms of public diplomacy, although more typically associated with state efforts. For example, when Japanese firms encountered anti-Japanese sentiments and general distrust in Southeast Asia in the 1970s, it was the Japanese government that took the initiative by virtue of Prime Minister Fukuda’s ‘heart-to-heart diplomacy’, a combination of overseas development aid and cultural promotion.<sup>80</sup> The top Japanese diplomat in China in charge of cultural affairs highlighted this difference: ‘in the Chinese case’, he said, ‘it is firms taking the lead’.<sup>81</sup>

Technical CSR, which aims to improve the local environment, provides technological solutions to environmental problems, or trains Chinese workers in technical skills, has two aims: cooperation with local government officials, and improving the skill-base of local workers. Utilizing a firm’s particular expertise, technical CSR tries to meet a local community’s social, developmental, or environmental needs. Technical CSR is at similar levels in both samples: 16% in 2005 and 17% in 2009. Technical training provides a district with more employable workers, in particular for more technologically sophisticated, highly skilled jobs. Attracting new high-tech companies into a district is beneficial to reaching economic growth targets and perhaps, for local officials, to career advancement.<sup>82</sup> These CSR projects help firms build a good relationship with a local government.<sup>83</sup> Large Japanese companies run training seminars in localities where they do business or are planning to do business, for workers they do not and may never directly employ.<sup>84</sup>

For example, a large electronics firm runs intensive technical training programmes in China that are intended to build positive relationships and leave good impressions of the firm on both the students and the local governments.<sup>85</sup> A chemical company, for instance, installed air filters in its China facility of the same quality as those used in its counterpart in Japan, even though the standard of this equipment surpassed that required by Chinese law at the time, and also outfitted other firms in the area with correspondingly similar air

78 Author interviews 14, 74, 80, 81, 88, 105, 117.

79 Author interviews 2, 6, 14, 15, 43, 71, 96, 106.

80 John Stirling, ‘Japan and Asia: A “Business Foreign Policy”’, *Asian Affairs*, Vol. 8, No. 6 (1981), pp. 353–63; Suelo Sudo, ‘Japan-ASEAN Relations: New Dimensions in Japanese Foreign Policy’, *Asian Survey*, Vol. 28, No. 5 (1988), pp. 509–25; Yoichi Funabashi, ‘Tokyo’s Depression Diplomacy’, *Foreign Affairs*, Vol. 77, No. 6 (1998), pp. 26–36.

81 Author interview 4.

82 Zhiyue Bo, *China’s Provincial Leaders: Economic Performance and Political Mobility Since 1949* (New York: M. E. Sharpe, 2002); Ye Chen, Li Hongbin and Zhou Li-An, ‘Relative Performance Evaluation and the Turnover of Provincial Leaders in China’, *Economics Letter*, No. 88 (2005), pp. 421–5.

83 Author interviews 5, 6.

84 Author interviews 32, 34, 74, 75, 82, 89, 121.

85 Author interview 87.

filtration systems.<sup>86</sup> Another example is that of a company manufacturing medical equipment, which not only made greater efforts than local companies to hire people with disabilities, but also used in-house facilities and products to promote accessibility for such workers in local businesses.<sup>87</sup>

Environmental measures, similarly, contribute to resolving China's serious and destructive environmental problems, which have been given more political prominence since the introduction in 2007 of Hu Jintao's 'scientific concept of development'. These measures, which help to build positive relationships with local government officials, also have the insurance-like qualities of CSR, although not necessarily against risks stemming from geopolitical tensions. A firm in the chemical sector reported that the local government closed down one of its factories after local residents downwind of it stridently complained of odours. Upon opening a similar factory in a different locality two years later, the firm waged an aggressive environmental CSR campaign, and received support from the local government when citizens lodged similar complaints.<sup>88</sup> Another firm reported the difficulties it experienced with the government of a locality wherein it sought to establish a new manufacturing facility over licensing and visa procedures, until it introduced the clean environmental technology that it would be bringing there.<sup>89</sup>

The 2005 survey contains reports of CSR activities conducted prior to the 2005 anti-Japanese demonstrations, or before the heightened perception of 'China risk'; the 2009 survey contains activities conducted after 2005. Concurrent with the heightened Japanese risk perception of China after the widespread anti-Japanese demonstrations in Spring 2015, the socially transformative CSR projects that firms use to transform risk also increased. This rise was accompanied by a decrease in local CSR projects, suggesting (though inconclusively) that firms shift their CSR strategies to respond to the risk environment rather than to increase the number of total projects. Technical CSR, however, has remained constant over time, indicating that the perceived need for this type of CSR has remained constant, and that change in risk perception does not necessarily dictate this kind of CSR strategy.

## **The Japan Chamber of Commerce and Industry in Beijing's Cultural Exchange Programme**

While the above analysis suggests that, concurrent with a rising level of geopolitical tensions, there was an overall shift in CSR programmes to ones that firms believed would counter the newly apparent dangers, it does not make clear whether targeted firms contribute more to these programmes, or how social transformation activities actually work. This section analyses individual firm participation in one of the largest cultural exchange programmes, and directly tests the three hypotheses. Where the survey discussed above was the first prong, this programme was the second prong of the strategy suggested by business elites after the unrest in 2005. The survey was funded partially by government funds, but the JCCI programme was entirely dependent on private contributions and implemented by

86 Author interview 88.

87 Author interview 81.

88 Author interview 69.

89 Author interview 86.

**Table 2.** Firm Contributions to the JCCI Program

Amount of contribution	Number of companies	Targeted in 2005 demonstrations (%)
Under 100 000 yen	3	0 (0%)
100 000 – 1 million yen	59	14 (24%)
1 million – 5 million yen	22	10 (45%)
5 million – 10 million yen	4	2 (50%)
10 million yen	15	15 (100%)
No contribution	59	59 (100%)
Total	101	101

the private sector. It thus provides an opportunity to examine the determinants of contributions from firms who opted into the programme.

The educational exchange programme, ‘Experience Japanese companies, Come close to Japan’,<sup>90</sup> gained rapid and widespread financial support from corporations, and the first wave of Chinese students came to Japan in July 2007. The initial goal was to secure funding for one year (two rounds) of the programme, but the corporate response in late 2005 and early 2006 was so positive that they received funding for 10 exchanges. The number of companies and their contributions are summarized in Table 2 below. The numbers are publicly available in the reports published by the Beijing JCCI after each round of the programme. One hundred and one companies (and two individuals) gave funds to the programme, with contributions ranging from under 100,000 yen (almost US\$900) to 10 million yen (more than US\$ 86,000).

The exchange programme invited Chinese college students to Japan for approximately 10 days to visit Japanese companies, have a short home stay, and experience Japanese cultural attractions. For example, the November 2007 programme featured visits to companies Omron, Toyota, Shiseido, Nippon Oil & Energy Company, Nippon Electric Company, Mizuho Bank, and All Nippon Airlines. Participants also had a one-night home stay, experienced a Japanese farm, stayed at a traditional Japanese hot spring resort, and visited Tokyo Disneyland. The emphasis of the programme was on exposing young Chinese to the best that Japan has to offer, primarily by highlighting the technological and managerial innovations and accomplishments of Japanese firms, but also through individual interaction like the home stay, and positive, fun experiences like the hot springs and Disneyland.

Organizers emphasized the importance of individual interaction with young Chinese.<sup>91</sup> Surveys conducted around the time of the riots indicated that few Chinese (only 1.1% of all respondents and 3.8% of students) had visited Japan, and a similarly small percentage had a friendly Japanese acquaintance.<sup>92</sup> The programme organizers targeted young Chinese for the economically motivated reason that these individuals have a lifetime of consumption

90 In Japanese, *Soukin Nikki, Kanju Nihon*, which literally means ‘run closely with Japanese companies, become receptive/sensitive to Japan’.

91 Author interviews 30, 119.

92 Yasushi Sato, ed., *Chuugokujin no Nihonjinkan, Nihonjin no Chuugokujinkan (Chinese Views of Japanese, Japanese Views of Chinese)*, Genron NPO and *China Daily*, Tokyo and Beijing, 2007.



and employment ahead of them. Young Chinese are also those among the population that claim the most negative impressions of Japan, something the organizers knew: the same 2005 survey found that 64.6% of students, but only 36.5% of total Chinese respondents, reported very bad or somewhat bad impressions of Japan.<sup>93</sup>

### Firm Participation in the JCCI Programme

The first two hypotheses posit that firms that are more vulnerable to political conflict risk will engage more in socially transformative political risk management, and the third that those firms with concerns relating not to Chinese society but to the state are less likely to do so. I test those hypotheses by observing how individual firm characteristics and experiences of political conflict influence contributions to the programme. Although all Japanese firms share the core characteristic of being Japanese, which potentially exposes them to political conflict risk in China, experiences of risk vary across type of firm and individual experience.

I argue that CSR contributions are predicted by a company's risk exposure, variables that measure the firm's market presence in China, and controls such as firm size, profitability, and industry. Probability of making a contribution (C) of a particular size is estimated with an ordered logit model:

$$\Pr(C = j) = \alpha + \beta_1(\text{Risk Exposure}) + \sum_i (\beta_i * \text{China Presence}) + \sum_i (\beta_i * \text{Controls}) + \varepsilon_i$$

with  $j$  equal to the five contribution brackets.<sup>94</sup> The outcome variable is contributions to the Japanese Chamber of Commerce and Industry in Beijing's educational exchange programme (Table 2), and takes on integer values from one to five. The precise value of contributions was not reported, but the brackets are easily and logically ordered, and non-linear, categorical inference is thus appropriate.<sup>95</sup> With a sample size of 101, and 11 explanatory variables, the sample is on the small but safe side for maximum likelihood estimation.<sup>96</sup>

The upper brackets of contributions contains companies that were targeted or otherwise directly affected by the fallout of Sino-Japanese tensions, and in the lower brackets are companies that had not *directly* experienced fallout from the anti-Japanese demonstrations of 2005, but which were operating in China. There are also seven companies related to

93 Sato, *Chuugokujin no Nihonjinkan, Nihonjin no Chuugokujinkan*, pp. 54–5. This result is not surprising: the younger cohort grew up hearing stories of atrocities of the Japanese invasion and occupation from family members, and also had their formative experiences in the era of patriotic education campaigns that emphasize those atrocities. The generation that came of age in the reform and opening up period also missed the apex of Sino-Japanese relations in the 1970s, when the Peace and Friendship Treaty was signed.

94 William N. Venables and Brian D. Ripley, 'Ordinal Logit Regression for Ordered Categorical Dependent Variables', in Christine Choirat, James Honaker, Kosuke Imai, Gary King and Olivia Lau, 'Zelig: Everyone's Statistical Software', 2011, <http://zeligproject.org/>.

95 J. Scott Long, *Regression Models for Categorical and Limited Dependent Variables* (London: Sage Publications, 1997), pp. 114–47.

96 Long, *Regression Models for Categorical and Limited Dependent Variables*, pp. 53–5. Ordinary least squares using the mean of each contribution bracket as the outcome variable obtains substantively similar results.

travel and tourism that did not have offices or production facilities in China, but which were affected by political conflict risk due to decreased rates of international travel. A visual check confirms a positive correlation between companies with higher risk exposure and greater donations. This observation, however, must be taken with caution: top donors are also large, wealthy companies with more resources available that, the existing business literature would predict, would invest more heavily in CSR regardless of political conditions, a factor controlled for in the model.

## Risk Exposure

The first key explanatory variable of interest is *risk exposure*. *Risk exposure* measures the degree to which firms directly experience political conflict. Extant literature on CSR and risk management does not examine political risk explicitly, but does measure other forms of risk such as targeting by environmental or labour activists,<sup>97</sup> or experience of lawsuits.<sup>98</sup> The literature indicates that a greater exposure to these social or political threats will be correlated with greater participation in CSR. Hypothesis 1 predicts that higher risk exposure will be positively correlated with higher contributions. It is possible that contributions could also increase exposure to risk by increasing the public visibility of a firm, which as noted above is a problem noted by firms themselves. Given that the JCCI programme was an *ex post* response to the risk exposure, however, this potential endogeneity is not a statistical issue, and the clear timing of the risk and the contributions make this an ideal case to test the hypotheses.

Risk exposure is measured using a media event count of adverse incidents Japanese firms encounter in China. The risk exposure variable is a count of how many times a firm in the dataset was directly targeted or impacted by anti-Japanese actions in China before or during the Spring of 2005. The event count was done using Japanese language newspaper articles from the *Nikkei Telecom*. I selected articles from the *Nihon Keizai Shimbun*, *Asahi Shimbun*, and assorted specialist newspapers whose focus is on particular sectors, such as construction, the stock market, electronic products, etc. The *Nihon Keizai Shimbun* (Japan Economic Times, usually called the *Nikkei Shimbun*) is the Japanese equivalent of the *Wall Street Journal*, or the leading daily national economic print news source. The *Asahi Shimbun* is similar to the *New York Times*, a daily national paper with a more liberal slant. The set of specialist papers do not command a national popular audience, but rather cater to firms or investors within the specific sector.<sup>99</sup>

More than two-thirds of the events in the dataset occurred in the Spring of 2005, during large-scale anti-Japanese demonstrations sparked by Japan's bid for a UN Security Council seat, and Japanese Prime Minister Koizumi Junichiro's visit to the Yasukuni Shrine, and include property destruction, boycotts, and cancelled business trips because of fears for employee safety. Aeon and Ito-Yokado, both large retail chains that have repeatedly been the

97 Donald H. Schepers, 'The Impact of NGO Network Conflict on the Corporate Social Responsibility Strategies of Multinational Corporations', *Business & Society*, Vol. 45, No. 3 (2006), pp. 282–99; King and McDonnell, 'Good Firms, Good Targets'.

98 Godfrey, 'The Relationship Between Corporate Philanthropy and Shareholder Wealth'; Godfrey, Merrill and Hansen, 'The Responsibility Between Corporate Social Responsibility and Shareholder Value'; Carroll and Shabana, 'The Business Case for Corporate Social Responsibility'.

99 A detailed description of the event count can be found in Vekasi, *China's Political Rise and Japan's Economic Risk*.

sites of anti-Japanese demonstrations, had windows broken or displays destroyed in Spring 2005. Large electronics companies, such as Toshiba and Canon, and automobile companies Toyota and Honda had display cases destroyed, and were targets of consumer boycotts. Consumers of their products were harassed or spit upon. Firms with high visibility offices and showrooms (such as automobiles or financial firms) boarded up their windows or placed black cloths over the company logo throughout the duration of the crises. Companies across sectors made decisions to forego participation in Chinese trade shows and cancelled business trips to China.

Newspaper reporting is necessarily limited, and in the case of the *Nihon Keizai Shimbun* and *Asahi Shimbun*, focused primarily on Beijing and Shanghai, with the exception of exceptionally large events in Chengdu and Xi'an. The press coverage also omits one of the most salient aspects of the post-crisis Chinese environment: cancelled events and missed opportunities. In the fast-paced and mercurial Chinese business world, two or three months of missed meetings, cancelled trade shows, or unsigned contracts can lead to a missed contract or lost business opportunity. These missed opportunities are an important aspect of exposure to political risk not represented in the dataset. While adding these immeasurable events would change the scale of risk exposure, however, it is unlikely that it would change the distribution of risk exposure across firms, so this measurement issue should not affect estimation.

### Other Explanatory Variables

I include three industry variables to test hypotheses 2 and 3: whether a firm sells directly to non-corporate Chinese consumers (*Consumer Oriented*), whether a firm is engaged in manufacturing (*Manufacturing*), and whether the firm is in a politically sensitive or strategic industry (*Strategic Sector*). Other explanatory variables include measures of a company's risk perception, including proximity to China's political centre (*Beijing*), how much experience a firm has in the China market (*Years in China*), and how important China is to the firm's operations (*China Facilities*).

Firms are coded according to whether their goal in the China market is selling to Chinese consumers or manufacturing. These classifications were made using firms' self-reported goals in the Toyo Keizai Databook. Some firms both manufacture and sell within China. Inter-firm sales (for example, from a component manufacturer to an end-product assembly firm) are also quite common, and are not included in the *Consumer Oriented* categorization. Of firms, 37.6% try to sell to Chinese consumers, and 58.4% are engaged in manufacturing. I argue that consumer-oriented firms are more likely to be concerned about backlash from Chinese society, and hence likely to contribute more to this cultural promotion programme. Firms in industries that the party has deemed strategic have not been liberalized to the same extent as industries that are deemed non-strategic, and will arguably exhibit patterns of behaviour different from more consumer-oriented firms or those in non-strategic manufacturing. These firms are in direct competition with Chinese state-owned enterprises, and the possibilities of political repercussions, such as state-sanctioned breach of contract, export constraints, or other discriminatory policies, are more acute. Using Hsueh's characterization of strategic industries within China's bifurcated liberalization globalization strategy, I thus code firms in the following industries as strategic: telecommunications, finance, automobiles, and energy.<sup>100</sup> Of firms, 20.1% are in industries that can be

100 Roselyn Hsueh, *China's Regulatory State: A New Strategy for Globalization* (Cornell: Cornell University Press, 2011).

considered strategic. These numbers are similar to overall Japanese FDI in China. In 2005, 58.02% of Japanese FDI was in a manufacturing sector and 17.5% in a strategic sector (this number does not include energy, as those industries were not included in the statistics).<sup>101</sup>

The importance a company places on being close to the centre of political power in China is arguably key to understanding whether, and how, they engage in political risk management. Beijing is the political centre of China, but is not the locus for FDI and foreign manufacturing, as are Southern China, Tianjin, or the Liaoning Peninsula. Companies that open a branch office in Beijing do so to be close to the centre of political power.<sup>102</sup> The variable *Beijing* is binary, and indicates whether a company has offices in Beijing; it is a proxy for the salience that a company's management team feels politics (including a broad range of issues from tax policy to possible joint ventures with large state-owned enterprises and more) has for their company's profit margin. Firms that see a need for presence in Beijing have a greater sense of political risk than firms that do not—an observation corroborated by the fact that large firms and trading companies that initially based their business in Shanghai have shifted headquarters to Beijing specifically to be close to the political centre of power. A large electronics firm, for example, moved its headquarters to Beijing after its CEO took an influential position in a Japanese business organization, so to more closely monitor the Chinese political situation.<sup>103</sup> Executives from large trading companies described a political/economic division of labour between branch offices in Beijing and Shanghai, respectively. Business matters are primarily conducted in the main Shanghai office, but the political work done in Beijing is indispensable to success.<sup>104</sup>

The degree of China experience (*years in China*) was calculated by subtracting the year the company was first established in China from 2005. Firms with a longer history of doing business in China are more experienced, have more available personal and business networks there, and may be less vulnerable to political risks, or at the very least less leery of them. Companies with China experience since the very beginning of the reform era (or before) have well-established and close political, as well as economic, relations. One company, for example, demonstrated its political connections through displaying a piece of Deng Xiaoping's personally inscribed calligraphy, and a photo of Hu Jintao shaking hands with the CEO.<sup>105</sup> General trading companies emphasize their experience by virtue of having weathered political transitions since the beginning of the reform and opening up era without withdrawing from China.<sup>106</sup>

*China facilities* is a count of the number of production or sales facilities a company has in China. This variable measures the salience of the China market for the company, as well as being an additional indicator of experience and visibility. Companies with more facilities in China have more stock in succeeding there, employ more people, and have more experience in establishing and maintaining production and sales facilities than companies with less. This variable should be positively correlated with contributions to the programme.

101 Chinese Ministry of Commerce, *Foreign Capital Statistics—2005*.

102 Author interviews 20, 32, 49, 69, 75, 83, 87.

103 Author interview 20.

104 Author interviews 70, 75, 83, 87.

105 Author interview 67.

106 Author interview 17, 69, 72.

**Table 3.** Explanatory Variables

Variable (predicted effect)	Min	Mean (SD)	Max
<b>Risk</b>			
Risk exposure (+)	0	0.84 (1.35)	6
<b>Industry variables</b>			
Consumer oriented (+)	0	0.38 (0.49)	1
Manufacturing (-)	0	0.58 (0.50)	1
Strategic sector (-)	0	0.21 (0.41)	1
<b>Control variables</b>			
Beijing (+)	0	0.59 (0.49)	1
Years in China (-)	0	8.84 (5.20)	20
China facilities (+)	0	6.75 (10.43)	56
Capital stock (billions of yen) (+)	0.2	154.0 (171.5)	1071
Employees in Japan (+)	0	12193 (15602.18)	80900
Return on equity (+)	0.28	11.13 (8.59)	46.92
Debt equity ratio (+)	0	1.48 (1.60)	9.84

Control variables include two measures of a firm's size (*capital stock* and *employees in Japan*), and two measures of a firm's profitability (*return on equity* and *debt equity ratio*). These two measures approach profitability from different directions. Return on equity measures a firm's profitability through the money shareholders have invested, while the debt equity ratio measures the extent to which firm profits are financed with debt. Firm size and profitability are also important because large, profitable firms also represent large tax contributions for the local government, perhaps giving the firm a more privileged political position (and perhaps less likely to need the kind of insurance CSR offers). The explanatory variables, and hypothesized effects, are summarized in Table 3. Firms with more financial and human resources at their disposal engage in more CSR activities.<sup>107</sup> Capital stock and total employees are taken from the Toyo Keizai Databook. The return on equity ratio and total debt to equity ratio are from the Mergent Online database.

## Results

Table 4 presents the results of the ordered logit model estimating the likelihood that firms will make contributions of varying sizes. Risk exposure is positively correlated with increased contributions; it is significant at the 0.0001 level with  $\beta = 0.64$ , offering support for hypothesis 1, that firms with higher risk exposure are more likely to invest resources in social transformation activities. However, neither a firm's consumer orientation nor the political or strategic salience of the firm's industry was significant; the model provides no statistical support for hypothesis 2 or 3. I thus found no evidence that firms trying to market products directly to consumers were more generous in their donations to social transformation CSR.

The lack of support for hypotheses 2 and 3 is intriguing, and suggests that, more than perceived marketing needs, it is an MNC's direct experience in the aftermath of political problems that triggers this risk management strategy. There is no empirical evidence to

107 Barnett and Salomon, 'Does It Pay to Be Really Good?.'

**Table 4.** Estimates of Contributions to the JCCI Exchange Program

Variable	Model 1	Model 2
Risk		
Risk exposure	0.63 (0.18)***	0.63 (0.18)***
Industry variables		
Consumer oriented	-0.4 -0.53	-0.4 -0.51
Manufacturing	-0.68 (0.49) <sup>†</sup>	-0.66 (0.0.48) <sup>†</sup>
Strategic sector	0.06 -0.68	0.06 -0.6
Control variables		
Beijing	0.61 -0.51	0.6 -0.51
Years in China	-0.08 (0.05)*	-0.08 (0.05)*
China facilities	0.09 (0.03)**	0.09 (0.03)**
Capital stock	3.34 (1.41)**	3.32 (1.39)**
Return on equity	0.01 -0.03	
Debt equity ratio	-0.02 -0.17	
Intercepts		
1   2	-3.45 (0.82)***	-3.47 (0.78)***
2   3	1.11 (0.60)**	1.08 (0.55)**
3   4	2.81 (0.67)***	2.79 (0.63)***
4   5	3.26 (0.70)***	3.23 (0.66)***
Residual deviance	189.37	189.42
AIC	219.37	213.42

Significance codes: \*\*\* $p < 0$ ; \*\* $p < 0.001$ ; \* $p < 0.01$ ; <sup>†</sup> $p < 0.05$ .

suggest that firms in strategic sectors have a different approach to this particular risk management technique from those in other sectors. This result provides further evidence that CSR as a risk management strategy is not aimed at a Chinese elite political audience so much as at Chinese society. It is the firms that found themselves targeted by society in the wake of geopolitical tensions and corresponding anti-foreign sentiment that invested more heavily in the programme. In future studies, if one were to perform a similar analysis on a broader sample of CSR that expands beyond social transformation projects, it is possible that support for the second two hypotheses could be found. In particular, analysing

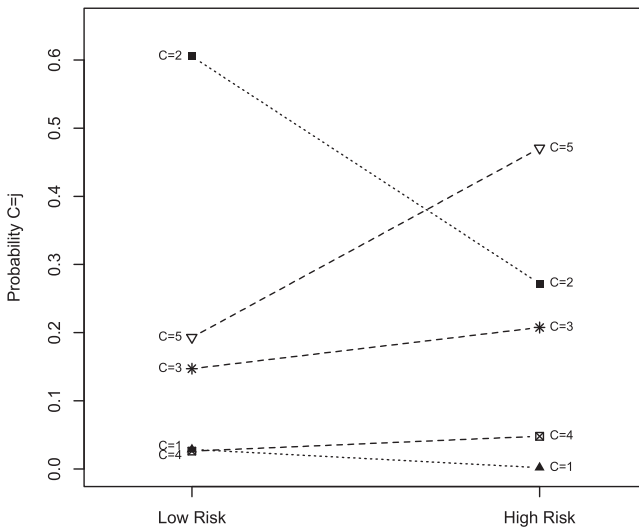


Fig. 1. Simulated Probabilities of Contribution Brackets.

contributions from firms that have abrogated their responsibility by violating domestic laws such as through labour, environmental, or product standards could provide further insight.<sup>108</sup>

Years in China is significant at the 0.01 level, and is negative as expected; the more experience a firm had in China led to lower contribution levels. Capital stock, a measure of firm size, is positively correlated and significant at the 0.001 level. A firm’s presence in Beijing did not predict contribution level. Likelihood ratio tests on restricted models excluding *Beijing* indicated that it could not be excluded from the model (similarly with the sector variables). Neither of the two variables measuring profitability was significant, or contributed to the model. They are excluded from further analysis. This result was surprising, as the CSR literature indicates that profitability is positively correlated with CSR.<sup>109</sup>

Using a simulation from asymptotic maximum likelihood models, I simulate the predicted probability of a firm falling into each bracket given a lower level and high level of risk exposure:

$$\Pr(C = j|x_i) = \Pr(\tau_{j-1} \leq C_i^* < \tau_j|x_i), j = [1 \text{ or } 5]$$

The simulated probabilities are presented in Figure 1. As firms move from low risk to high risk, their contribution behaviour changes. For the two lowest contribution categories (C = 1 or 2), the probability a firm gives at that level falls as exposure to risk rises; the inverse relationship exists in the three highest contribution brackets (C = 3, 4, or 5). The result is particularly pronounced for categories 2 and 5: the probability that a firm donates in

108 I am grateful to an anonymous reviewer for this point.

109 As a robustness check, I also ran two models with controls for prior CSR contributions—one with all types of CSR and one that included only prior social transformation-style CSR. The variables were not significant, and did not alter the underlying findings of the analysis.



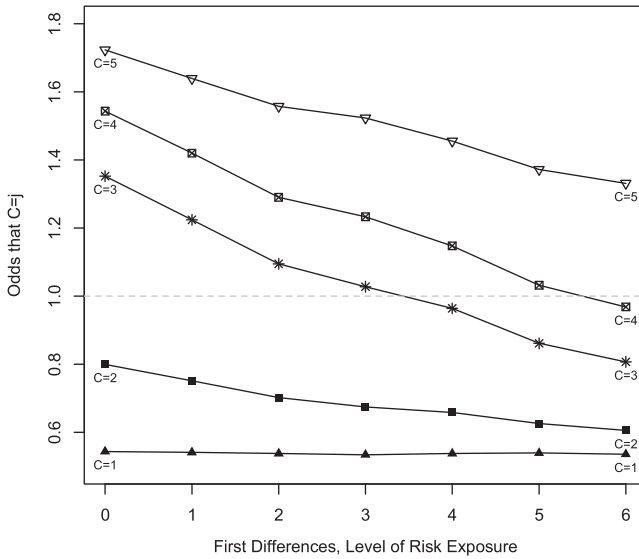


Fig. 2. Risk Ratio Given Additional Exposure to Risk.

category 2 falls from 0.61 to 0.27, and in category 5 increases from 0.19 to 0.47. As firms are exposed to more risk, therefore, they will put more financial resources into countering that risk.

The risk ratio, or the relative odds of a firm contributing at a certain bracket if directly exposed to one additional incident of risk, also tells an interesting story. Figure 2 shows the risk ratio

$$= \frac{Pr(C = j | Risk = i)}{Pr(C = j | Risk = i - 1)}$$

for all categories  $j = [1:5]$ . When the risk ratio is greater than 1, it indicates that when a firm is exposed to an additional incident of political risk, the predicted probability that will fall into that contribution bracket will increase. In the top contribution bracket, a change from no direct risk exposure to one instance almost doubles the odds that a firm will contribute in the highest bracket (odds that  $C = 5$  are 1.7), whereas a move from one instance to two has odds of 1.6. A similar effect is in play for  $C = 3$  and  $C = 4$ . In the lower brackets, the risk ratio is never greater than 1, indicating that additional exposure to risk decreased the odds that a firm would contribute in a lower bracket. For the lowest bracket, increased exposure to risk makes no substantive change to the risk ratio.

These figures suggest that the *initial* effects of risk exposure are the most important, because additional incidents do not have the same degree of effect on the odds. The first time a firm is the target of a consumer boycott or gets its windows smashed is a more important instigator of firm behaviour than the second time, and so on. Risk exposure has diminishing marginal returns on contributions to this social transformation programme. A direct experience with business consequences from geopolitical tensions activates a sense of immediate

danger. Once that sense has been activated, additional exposures have a smaller effect on behaviour.

Interview responses corroborate this result: respondents from firms that had no direct risk exposure were more optimistic about whether political conflict presented a risk to success in China. Although they were exposed to stories of firms, products, or even employees being targets of angry Chinese patriots, their own personal experience told a different story.<sup>110</sup> Respondents from firms with a direct experience of political conflict risk (for example, their own or a colleague's cancelled business trip, seeing a demonstration at or near their place of work, or watching their product being destroyed) were much more alarmist, even when referring to events that occurred four or five years previously.<sup>111</sup> After the initial direct exposure, additional incidents had less influence on risk perception.

### **Efficacy of Private Sector Public Diplomacy**

Variation across participating firms in the JCCI programme indicates that the firms with greater risk exposure are those more drawn to CSR programmes targeting Chinese society at large and promoting Japan's public image. These results imply that risk perception is motivating a shift in political risk management strategy towards a public diplomacy or hearts-and-minds approach. This political risk management strategy has been necessitated by shifts in China's place in the world, as well as domestic political changes within the country.

The social transformation activities of Japanese firms in China are intended to counter China's domestic politics of anti-Japanese nationalism (a difficult task unlikely to achieve resounding success given the level of saturation in China of anti-Japanese material) but one Japanese firm as well as state officials that I interviewed nevertheless believe that this is the correct path. In response to a disadvantageous business environment created by such state-sponsored xenophobic nationalism, Japanese firms allocate financial resources to social contribution programmes geared particularly to young Chinese that promote their home country. Firm officials do not expect quick corporate returns from social engagement programmes, but rather are investing in the long-term future of Sino-Japanese relations. As to the efficacy of the programme, it is naive to expect a visible reconstruction of anti-Japanese nationalism; decades of patriotic education are not easily countered. There are, however, three ways to initially assess efficacy: feedback from specific programmes such as the JCCI exchange, macro-level public opinion, and firm-level effects.

Officials from the JCCI clearly indicated that their expectations of the programme were long term: they did not expect to turn Chinese society pro-Japanese overnight, but rather to see a transformation of attitude over the next 30 years, or the passage of a full generation. A judgment at this stage was hence premature. From the perspective of a profit-seeking firm, however, a 30-year return on investment is unacceptable; it is reasonable to assume that firms expected quicker results and that assessing the programme in the shorter term is appropriate. Recruitment of Chinese talent to Japanese corporations was neither a stated nor implicit goal of the programme. Contributions to the programme represent optimism that the ability for individual exchange and exposure to the 'other' will make a difference to tense interstate relations, and also a willingness to invest resources in that goal.<sup>112</sup>

110 Author interviews 66, 74, 80, 88, 90, 92, 93, 108.

111 Author interviews 52, 53, 61, 62, 67, 71, 72, 102, 103, 106.

112 Author interviews 30, 119.

Participants' written evaluations, albeit far from scientifically reliable indicators of the programme's effect, suggest that the programme is successful in imparting a favourable impression of Japan. Some students spoke directly of their negative beliefs about Japan being challenged or their fears about the country overturned. One student said he was relieved not to see military units in the streets, so implying the depth of misperception about Japan that the programme was up against. The consideration that service providers (wait staff, bus drivers, etc.) showed for their foreign guests struck many participants, one of whom commented: 'the consideration and attention to detail of the Japanese was impressive', and others remarked on the kindness and energy that Japanese waiting staff displayed in their jobs. Students also made much of the degree of automation and technical expertise in the companies visited, such as Omron and Toyota.

In her final summary, a Nankai University student spoke directly to the Chamber of Commerce and participating companies' goals: Japanese companies, Come close to China! Let's deepen mutual understanding between Japan and China! Let's promote feelings of Sino-Japanese friendship through future generations!<sup>113</sup> Perhaps a stronger indicator of programmatic success lies in the fact that the programme proved resilient to political pressures: in the falls of 2010 and 2012, when cancellations of such programmes were rife due to territorial conflicts, Chinese students still visited Japan through the JCCI programme.<sup>114</sup>

Macro-level public opinion paints a much more pessimistic picture: annual surveys of both the Chinese and Japanese publics conducted annually by Genron NPO and the *China Daily* show that negative impressions of Japan within China have increased since 2005. While there was a brief decrease in negative views from 62.9% in 2005 to 36.5% in 2007, they stood at above 90% in 2013.<sup>115</sup> Notably, Japanese public opinion about China is similarly negative: the countries are increasingly at odds with each other on official levels and within citizen attitudes. While it is easy to dismiss the private sector's efforts in these areas as either ineffective or perhaps quixotic, it is interesting to note that firms are investing their scarce resources despite these barriers.

Lastly, efficacy can be evaluated on the firm level. Using the same event count methodology employed to measure risk exposure, it is possible to see whether firms that donated more to Japan-promoting social transformation CSR were more or less likely to be targeted in the 2012 anti-Japanese protests, which occurred after the donations had been made. The conclusions from this analysis must be taken with great caution: the 2012 protests were greater in scale than those in 2005, and many protests focused on certain industries (for example, the highly visible automobile companies) regardless of inter-industry firm-level attributes. Using the same sample of JCCI contributing firms, the mean of risk events increases from 0.84 to 0.92 incidents between 2005 and 2012, and the maximum number of risk events from 6 (Japan Steel in 2005) to 12 (both Toyota and Nissan in 2012). An ordinary least squares using contribution category and risk exposure in 2012 gives an estimate of  $\beta = -0.387$  ( $p < 0.043$ ), indicating that higher contributions indeed made individual firms less likely targets for social anger.

113 This quote and others from Japan Chamber of Commerce and Industry, *Gakuseitachi no kansoubunkara (From Student's Written Impressions)*, 2007.

114 For example, high school exchange programmes, cross-national union solidarity, Japanese art exhibitions in various cities in China were all cancelled.

115 See <http://www.genron-npo.net/world/archives/6011.html> for annual data.

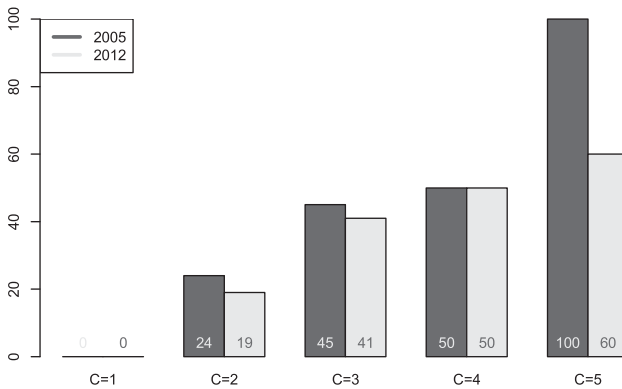


Fig. 3. Percent Firms Targeted by Contribution Levels, 2005 and 2012.

Figure 3 shows the percentage of firms in each contribution bracket targeted in 2005 and 2012 (note that these percentages do not take into account the discrete number of times a firm was targeted as the regression does). Excepting the lowest contribution category, which was at zero in both years, all contribution levels saw decreased or unchanged percentages between 2005 and 2012. The percentage of firms targeted in the highest contribution level fell from 100% to 60%, providing some evidence on the firm level that these contributions were effective in risk mitigation. However, more work is needed as regards the efficacy of these strategies in the future.

### Alternative Strategies

As discussed above, MNCs have alternatives to public diplomacy-like risk management strategies, such as developing protective and mutually beneficial relationships with local authorities or completely or partially exiting the market. Japanese multinationals in China also use these strategies; CSR is but one tool in a broader risk management plan. While in-depth analysis of firm-level variations in the use of these strategies is beyond the scope of this article, they merit a brief discussion of how they work in tandem with the social engagement strategies discussed here.

In circumstances of heightened risk perception after political tensions, it is possible that firms do not exit a country, but rather choose to make new investments elsewhere, or shift a small proportion of their overseas production to a location perceived as a more stable, less risky environment. In the face of a changing business environment within China and increasing political risk, one option is for firms to diversify internationally, especially to South and Southeast Asia.

While a complete market exit is still rare (though increasing),<sup>116</sup> a diversification strategy known as ‘China plus one’ is one response of Japanese firms to challenging political and economic conditions. Notwithstanding the centrality of China’s large and rapidly expanding domestic market, as well as its abundance of labour and favourable investment

116 For a list of firms exiting China, see *21 seiki Chuugoku soukenron: Chuugoku shinshutsu kigyō ichiran 2013-14* (21st Century General Research on China: Firms Invested in China 2013-14)(Tokyo: Sososha, 2015), pp. 82–9.

climate as regards infrastructure, labour costs are increasing annually (in some areas of China as much as 20% per year), environmental regulations are becoming stricter, and preferential tax policies for foreign investors are disappearing. A China plus one strategy, therefore, maintains China as the primary target country for investment, but also adds a new manufacturing capability in an additional country to mitigate risk in the event of a disruption of production in China. Political instability is sometimes the trigger for a firm's exit. For example, president of Sumitomo Electric Matsumoto Masayoshi was quoted in *Bloomberg* during anti-Japanese protests in 2012 as saying: 'Our board members had been vaguely wondering if we should move future production out of China; then the protests prodded us to decide to accelerate planning toward moving out.'<sup>117</sup>

China plus one is an economic strategy pursued by the private sector that the Japanese state also promotes. The Japanese government, spearheaded by the Japan External Trade Organization (an investment promotion organization affiliated with the Ministry of External Trade and Industry), promotes China plus one as a policy to reduce Japan's economic dependence on China—not just in efforts to maintain production stability but also to maintain independence from China in economically strategic sectors.

There are also substantial barriers to China plus one. Some large Japanese firms and economic consultants remain sceptical of the strategy, believing that long-term stability of the Chinese market mitigates macro-economic risks, and hence choose to diversify domestically into Western China rather than shifting production to Vietnam or India. Furthermore, the nature of Japanese production networks makes it difficult, in some cases perhaps prohibitively so, to shift production of just one facility to a new overseas location.<sup>118</sup> The social engagement activities are thus a necessary hedge for firms committed to the domestic market.

Local governments are also a potential buffer for MNCs against any anti-Japanese backlash. Although the Chinese central government has locked itself into a xenophobic stance that makes explicitly pro-Japanese policies exceedingly difficult,<sup>119</sup> localities want to attract Japanese investment because of the economic opportunities, crucially including new additions to the tax base, they bring. When protests or threats due to actions of the central government make the Chinese market threatening to Japanese MNCs, it is in the interests of localities to protect and retain such firms. The same tension briefly described above with regard to the Sichuan Earthquake—where the material interests of the local government conflict with the ideological interests of the central government—can be observed here.

Amid the fallout from Sino-Japanese tensions, Japanese managers have reported local protection. In larger cities, the local equivalent of the Japanese Chamber of Commerce reported being contacted by the Ministry of Public Security, informed of the timing and location of protests, and assured that they would be safe as long as they exercised appropriate caution.<sup>120</sup> In more rural areas, local police contacted dispatched firm managers with

117 Masatsugu Horie and Ma Jie, 'Japan Curbing China Investment as Feud-Weary Firms Flee', *Bloomberg*, 2012, <http://www.bloomberg.com/news/2012-11-11/japan-curbing-china-investment-as-feud-weary-firms-flee.html>.

118 Masahisa Fujita and Nobuaki Hamaguchi, 'The Coming Age of China-plus-one: The Japanese Perspective on East Asian Production Networks', background paper for *Dancing with Giants: China, India, and the Global Economy* (Washington, DC: Institute for Policy Studies and the World Bank, 2006).

119 Shirk, *China*.

120 Author interviews 30, 33, 35, 37, 39.

similar messages.<sup>121</sup> One manager reported his surprise and gratification that the ‘police officer recognized me as a Japanese, and had thought about my safety’.<sup>122</sup> Local officials have material incentives to attract and retain Japanese MNCs, yet the central government has incentives to use anti-Japanese sentiment as a tool in domestic politics. Even as firms are reassured locally with respect to their long-term welcome, the uncertainties as regards fallout from uncontrollable foreign policy decisions also necessitate the broader social engagement strategies outlined in this article.

## Conclusion

The political ramifications of multinational firms’ social engagement activities abroad are complex. One implication of social engagement strategies is that when faced with a deleterious business environment, these firms do not exit the market but rather choose to stay and engage with the society of workers and consumers from whom they hope to profit. In circumstances of high political uncertainty, when firms cannot predict where or when the business environment will be negatively affected by geopolitical tensions, these results imply that firms will attempt engagement strategies in efforts to alter the foundations of animosity towards the firm’s home country in which the risk is rooted. In this case, Japanese firms attempt to soften the teeth of anti-Japanese sentiment by transforming the attitudes that inform it by promoting a positive image of Japan and Japanese society. If successful, Japanese firms would then no longer present an easy target for discontented Chinese who cannot directly express their frustration to their authoritarian government. The tactic is not one used solely by Japanese firms: Carrefour, for example, a French firm similarly targeted by nationalist activists in China, used a similar strategy in 2008.<sup>123</sup> These patterns are not evident if one looks at macro financial flows or even firm-level movements; the result is found in the firm strategies themselves.

Social strategies taken by firms—largely classified under the umbrella of CSR activities—are a set of *non-economic* measures to protect their economic interests. CSR activities, although social, environmental, or philanthropic in nature, are political in their consequences: firms use CSR to transform the risk environment in which they are embedded. Firms engage in CSR activities strategically to minimize risks to profits or contracts, but they also have important political consequences: CSR makes overseas business actors not only into providers of a commercial products or employment opportunities, but also merchants of their home country.

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121 Author interviews 86, 91, 94, 104, 107.

122 Author interview 86.

123 Groupe Carrefour, *At the Heart of Life: 2008 Sustainability Report*, 2008, p. 47; see also Jason Subler, ‘Foreign Corporate Post-Earthquake Aid Eases Chinese Nationalist Anger’, *New York Times*, 19 May, 2008. <https://www.unglobalcompact.org/system/attachments/2702/original/COP.pdf?1262614347>.