

Strategic Responses to Domestic and Foreign Institutional Pressures in the Chinese Toy Industry

Mike W. Peng

University of Texas at Dallas
School of Management, Box 830688, SM 43
Richardson, TX 75083
Tel (972) 883-2714 / Fax (972) 883-6029
E-mail: mikepeng@utdallas.edu
www.utdallas.edu/~mikepeng

Hao Chen

University of Texas at Dallas
School of Management, Box 830688, SM 43
Richardson, TX 75083
Tel: (972) 883-6112 / Fax: (972) 883-6029
E-mail: chloechenhao@utdallas.edu

Forthcoming, ***International Studies of Management and Organization***

First submission: March 2008; First revision: May 2008; Second revision: June 2008

This revision: August 2008

Mike W. Peng and Hao Chen are, respectively, the Provost's Distinguished Professor of Global Strategy and a PhD student at the University of Texas at Dallas (tel: (972) 883-2714; fax (972) 883-6029; e-mail: mikepeng@utdallas.edu). This research was supported in part by a National Science Foundation CAREER Grant (SES 0552089). We thank Mehdi Farashahi and Rick Molz (Guest Editors) for their encouragement and guidance. All views and errors are those of the authors and not those of the NSF.

Strategic Responses to Domestic and Foreign Institutional Pressures in the Chinese Toy Industry

Abstract

It has been well established that firms strategically respond to institutional conditions. Much of this work deals with how firms respond to domestic institutional constraints, and a smaller literature focuses on how foreign entrants respond to host country institutional frameworks. However, a substantial number of firms are active in international business and yet they remain “domestic” by staying in their home countries—exporters and outsource service providers come to mind. How these firms react to changes in both domestic and foreign rules of the game, as well as the interactions between these two sets of rules, remains underexplored. Taking advantage of the recent product recall crisis, this timely exploratory study probes into how firms in the Chinese toy industry strategically react to the institutional pressures from both home and abroad. Implications for a strategic response framework are discussed.

An institution-based view of strategy posits that firms strategically respond to the opportunities and constraints presented by the institutional frameworks (Peng, 2003; Peng and Khoury, 2008; Peng et al., 2008). While the proposition that “institutions matter” is hardly novel or controversial, what is interesting is how institutions matter (Hafsi and Farashahi, 2005; Meyer et al., 2008). Some scholars have investigated how firms respond to domestic institutional conditions (Bourgeois and Eisenhardt, 1988; D’Aunno et al., 2000; Dacin et al., 2002; Flier et al., 2003; Oliver, 1991, 1997). A smaller literature focuses on how foreign entrants, primarily multinational enterprises (MNEs), respond to host country institutional frameworks (Child and Tsai, 2005; Chung and Beamish, 2005). Relatively unexplored is the nontrivial question of how firms strategically respond to both domestic and foreign institutions, especially to the interactions between them (Zhou and Li, 2007). There are a substantial number of firms active in international business (IB) and yet they remain “domestic” by staying in their home countries—exporters and outsource service providers come to mind. To these firms, both home country and host country institutions are the rules that they need to obey because they need legitimacy from both countries to remain in the game. How do these internationally active but domestically based firms strategically respond to institutional pressures from both home and abroad?

Taking advantage of the recent toy recall crisis in the Chinese toy industry, this article probes into this interesting but unexplored question. According to China Central Television’s (CCTV) 2008 reports, 75 percent of the toys in the world market were made in China, 70 percent of which were made in Guangdong Province alone. Thus, in this article, we examine toy manufacturers in China that received recalls from the United States, especially those in Guangdong Province, using both print and online publications. We have also conducted online search in both English and Chinese, because the reaction from the Chinese side—the focus of this article—may differ from the U.S. side. To further illustrate the attention on the recalls, we have conducted online searches

using key words “toy recall in the U.S.+ year” in Google and “wan ju zhao hui (“toy recall” in Chinese) + year” in Baidu (China’s most popular search engine). Results are shown in Figure 1, which is indicative of the unprecedented scale and scope of these recalls as reported by online media in both English and Chinese. Announcements of toy recalls is released by the Consumer Product Safety Commission (CPSC), an official U.S. government agency whose main concern is to ensure the safety of consumer products, such as toys, cribs, power tools, cigarette lighters, and household chemicals. According to CPSC, the first announcement on toy recalls in the United States was released in 1974 by a U.S. manufacturer. It was not until 1988 that the first recall announcement on toys made in China was released. The number of recall announcements grows over the years ever since. Figure 2 illustrates the increase in the number of recall announcements in the United States over the last decades.

[Insert Figure 1 and Figure 2 about here]

By conducting an explorative study on Chinese toy manufacturers, we explore the strategic responses of these firms that are exporting to the U.S. market or contracting with U.S. toy companies, when facing institutional pressures in both China and the United States. Extending a strategic response framework (Clarkson, 1995; Oliver, 1991; Peng, 2006, 2009), we use exploratory illustrations in the context of toy recalls, which can be viewed as a “natural experiment” to see how firms react differently.

While there is no shortage of press reports, academic studies on the Chinese toy recall mess are rare. A practitioner-oriented report by two scholars (Bapuji and Beamish, 2007) and two teaching cases by the same authors (Bapuji and Beamish, 2008a, 2008b) are the *entire* universe of academic work that we have uncovered in our research. All the three pieces by Bapuji and Beamish (2007, 2008a, 2008b) focus on U.S. toy companies, especially Mattel, and are descriptive

in nature. As a result, there is a dearth of research on how the *other* side of the product recalls reacts. To the best of our knowledge, our article is not only the first academic study that investigates how the Chinese toy exporters have responded, but also the first such study that draws on theoretical frameworks such as the institution-based view (Peng et al., 2008).

While our article enjoys some first-mover advantages, it, unfortunately, also comes with many trappings associated with first-mover disadvantages. The events are recent. The dust has not all settled. Data are incomplete and hard to access. Some of the firms were bankrupt. In one extreme case, the executive of a firm committed suicide, making further extraction of information impossible. Emotions are high from both sides—ranging from angry parents and disappointed officials on the U.S. side to depressed Chinese executives who argue that they have become scapegoats for mostly design flaws and officials who worry about the damage to the “China Brand” on the Chinese side (Bapuji and Beamish, 2007). Nevertheless, we suggest that the contributions of this article outweigh its drawbacks, because exploratory work such as ours is not only timely but also *interesting* in the best tradition of Davis (1971) and Smith (2001).

THEORETICAL BACKGROUND

The institution-based view argues that both formal and informal institutions are “the rules of the game,” which firms need to conform to remain legitimacy (Meyer et al., 2008; Peng, 2003; Peng et al., 2008; Scott, 2001). Legitimacy for a firm also comes from the acceptance of the firm by stakeholders in its environment (Kostova and Zaheer, 1999). Thus, firms need to respond to pressures from their stakeholders and the institutions to gain and remain legitimacy (Hafsi and Farashahi, 2005). In addition, firms in IB face diverse stakeholders and different institutions from various countries (Xu and Shenkar, 2002). Especially to firms that are active in IB and yet remain

“domestic” by staying in their home countries, for example exporters and outsource service providers, both home country and host country institutions are the rules that they need to obey because they need legitimacy from both countries to remain in the game. The Chinese toy manufacturers in this context are ideal for our study for the following reasons.

First, the Chinese toy manufacturers that are involved in IB by manufacturing toys domestically and exporting toys to foreign importers face both domestic and foreign institutions. They need to deal with both domestic and foreign stakeholders to maintain their legitimacy in the market. Second, they need to comply with domestic and foreign institutions. In order to remain legitimate in their domestic market, Chinese toy manufacturers need to comply with regulations and social norms (Carroll et al., 1988; Edelman and Suchmen, 1997; D’Aunno et al., 2000) in the Chinese toy industry. Furthermore, they need to act according to institutional demands stemming from their foreign partners’ countries to remain legitimate in the eyes of foreign stakeholders, such as importers, consumers, and governments.

Third, when domestic institutions are influenced by foreign institutions—in our case when the Chinese government issued regulations and legislations to further standardize the toy industry after receiving pressures from the U.S. institutions—Chinese toy manufacturers became alert of such interactions between the institutions from both countries. Consequently, only firms that are aware of and obey these rules have survived (Sherer and Lee, 2002; Tolbert and Zucker, 1983). Thus, for the Chinese toy manufacturers that export to the United States (which is their largest market), the institutional pressures from both home and host countries together determine their legitimacy at home and abroad. Figure 3 illustrates the pressures that the Chinese toy manufacturers face from four dimensions.

[Insert Figure 3 about here]

Institutions may assert their influence informally (through norms and values) or formally (through regulations). While informal means take their effect relatively slowly, formal pressures, often through the stroke of a pen, can materialize almost immediately. Product recalls represent an example of immediate formal pressures backed by the coercive power of governments (Bapuji and Beamish, 2007).

The institution-based view also argues that when firms make strategic choices, they tend to adopt the strategies that are perceived to be legitimate by their stakeholders and institutions (Flier et al., 2003). Often times, these strategies diffuse through the industry and are perceived to be legitimate (Greenwood and Hinings, 1996; Meyer and Rowan, 1977). This gives us a reason to look for the possible strategic response model to explain how firms react under pressures from institutions. However, firms need both internal and external pressures to adopt these legitimate strategies (Sherer and Lee, 2002). Firms in the Chinese toy industry are diverse in size, capability, resources, and ownership. Some firms become early adopters of certain strategies because they are driven by technical-competitive reasons and some become late adopters that are driven by a quest to conform to the legitimate strategies (Sherer and Lee, 2002; Tolbert and Zucker, 1983). Moreover, some firms may not join the adopting process due to lack of resources or pressures.

There are approximately 10,000 factories in China that export toys. At issue is how these toy exporters strategically respond to foreign recalls if they want to remain in both domestic and international business. Not surprisingly, their strategic responses differ, leading to a strategic response framework outlined next.

A STRATEGIC RESPONSE FRAMEWORK

At its core, the institution-based view focuses on how institutional conditions impact strategic

choices (Peng, 2003; Peng et al., 2008). A strategic response framework on how firms strategically respond to challenges from the institutional environment has been first developed by Clarkson (1995) and Oliver (1991) and more recently extended by Peng (2006: 129). We have further extended this framework by adapting it to the realities of the toy industry. We argue that the two key dimensions are attitude toward responsibility and timing of taking action. Shown in Figure 4, three broad strategic choices along these dimensions are: (cell 1) passive, (cell 2) defensive, and (cell 3) proactive strategies. To note that theoretically firms may exist in cell 4, where they deny their responsibility but still are able to act before receiving recalls. However, in the Chinese toy industry, we cannot find any case that fits this cell. Therefore, we refrain from commenting on it.

[Insert Figure 4 about here]

Passive Strategy

For firms active in IB and yet remain “domestic” by staying in their home countries, they face internal pressures to follow the formal institutions in their country, such as the laws, regulations, and product standards, because they need the approval of the home country’s formal institutions to remain legitimate in the game domestically (Kostova and Zaheer, 1999; Peng et al., 2008). They also face the multiplicity of host country institutions, because they need the acceptance of their foreign partners or importers. Multiple institutional environments create different requirements for firms to maintain legitimacy in a global setting (Kogut, 1991; Kostova and Zaheer, 1999). These requirements may be different from firms’ “domestic” settings, thus creating difficulties for them to adapt and conform (Oliver, 1991). When facing such foreign institutions, firms do not feel compelled to adhere completely to the foreign industry-wide norms that value quality, in the absence of formal pressures or disasters. Firms may deny their responsibility in the global market

and fail to respond timely when receiving pressures from host country institutions. When disasters come from abroad, it may be too late for them to choose any strategic plans to survive. Although they are staying at home, when they lose their legitimacy in the global market, they face difficulties to compete with other firms that value foreign institutions and conform to the host country's rules. As a result, they may lose their positions in the domestic market. When domestic institutions change with the foreign institutions, the non-conforming firms may lose their legitimacy at home eventually and cannot survive. To sum up, we theorize this type of strategic response as a "passive strategy." In this process, firms that choose a passive strategy have failed to convey their responsibility to stakeholders in IB and developed in a way that will introduce more problems and lead to their loss in profits in the end.

Some family owned firms in the Chinese toy industry fit into this category. The Chinese toy industry began its development in the 1980s. A lot of firms are family owned. They often make strategic decisions based on the individual relationships of their owners. Although foreign investors from Japan, Korea, and other countries have flowed in, the main actors in the industry are still family-owned, private Chinese firms. These firms are most likely to ignore the problems that exist in their operations and overlook the mistakes they have made along their developments. They also tend to act after recalls are announced, for the reason that only damage to their profits may attract their attention.

To better illustrate this concept, we use Lee Der Toy Company as our example. Lee Der was founded in 1993 in Foshan, Guangdong Province in China. The company is a joint venture established by Fenjiang Industrial Company from Chancheng District, Foshan, and Lee Der Industrial Company, Limited, from Hong Kong. Both parent companies owned 50 percent of the stakes of Lee Der. For more than ten years, Lee Der had been producing toys and toy parts for Mattel, Inc., a toy giant in the United States that markets leading toys such as Barbie and Fisher-

Price toys. Before the recall, Lee Der was the second largest toy manufacturer in Foshan.

On August 2, 2007, Fisher-Price, a subsidiary of Mattel, reported the recall of 967,000 pieces of plastic preschool toys made by Lee Der to CPSC (Bapuji and Beamish, 2008a, 2008b). These toys were reported to contain excessive amount of lead in the paint. Due to the pressures from the public, Fisher-Price revealed the name of its Chinese contract manufacturer, Lee Der, to the press. It was the first time for a U.S. company involved in a recall to release its Chinese supplier's information directly to the press.

The reason for toys that Lee Der made to contain excessive amount of lead is that Lee Der's paint supplier, Dongxing New Energy Limited, supplied Lee Der with "fake paint." Mattel had been requesting its Chinese suppliers to use paint from its contract paint suppliers or to test each batch of the paint purchased from a non-certified supplier. Lee Der apparently violated these rules. Dongxing was not on Mattel's contract paint supplier list, and the paint from Dongxing was not tested by Lee Der. In fact, the boss of Dongxing is a friend of Shu-hung Cheung, vice chairman of the board of Lee Der. According to company records, Cheung owned one-fourth of Lee Der. He was also the primary strategic decision maker in the company. After the recall, Chinese officials temporarily banned Lee Der from exporting products. The action taken by Chinese officials is a result of the pressures from the U.S. institutions. In total, the recall cost Lee Der US\$30 million. After the recall, Lee Der found itself in a difficult position facing criticisms from both institutions. Lee Der tried to make some amendments after the recall. For example, it produced new toys, which it claimed to have passed the quality test and accorded with the U.S. standards. However, everything seemed in vein. Two weeks later, Cheung committed suicide in his factory warehouse under pressure. This brought an end to Lee Der.

In this illustration, Lee Der represented a firm that chose a passive strategy to deal with institutional pressures from both home and host countries. It denied its responsibility as a supplier

and contract manufacturer and violated the rules of the game. It also acted after recalls that made itself more passive under increasing institutional pressures. When both domestic and foreign institutional pressures arrived, Lee Der became vulnerable and helpless. Especially when home country institutions change under the pressure from host country institutions, Lee Der lost its last hope—to depend on the support from its domestic institutions. Once a firm ignores the existing problem or mistakes it makes, it overlooks the possible negative outcome from those mistakes. When institutional pressures take place, such as recalls announced, it may have no time to respond strategically, not to mention the lack of resources it can pool to help it through. In summary:

Proposition 1: Firms that ignore both domestic and foreign institutions and respond passively to institutional pressures face the highest probability of losing their legitimacy in IB.

Firms adopting a passive strategy often put themselves in an awkward position that although they aim at making profits, they lose the most in the process of denying their responsibilities and acting after recalls. They may even face the “death penalty” by being forced out of market due to their lack of adherence to the rules from both home and abroad. According to the press conference held by China’s Central Government on January 14, 2008, the General Administration of Quality Supervision, Inspection, and Quarantine (ADSIQ) conducted a general investigation on toy manufacturers in China. It withdrew the export licenses for more than 600 toy companies that were not qualified for producing safe toys. This is an alarm for the Chinese toy industry. As long as companies remain passive in strategic responses, they will face the difficulty in maintaining legitimacy in IB.

Defensive Strategy

Similar to firms choosing a passive strategy, firms that choose a defensive strategy also face the

pressures from both domestic and foreign institutions. The only difference between them is that firms adopting a defensive strategy acknowledge the influence of both formal and informal institutions and accept their responsibilities. They admit their mistakes and try to improve. While they pay attention to the institutions' demands, they only do what is required by their domestic institutions. How they respond to foreign institutions is relatively defensive, depending on whether the pressures from the institutions bring problems to their legitimacy in IB. They only act after foreign institutions apply direct formal pressures on them (Kostova and Roth, 2002), such as the arrival of recall announcements. It seems that they lack the willingness and ability to change ahead of time. This may be due to the fact that these firms fail to consider the legitimacy they need from the informal institutions, which are more difficult to sense (Gersick, 1990; Kostova and Zaheer, 1999). When firms defensively choose strategy in response to pressures from foreign institutions, they create an image of ignoring rules of the international market, which jeopardize their reputation in IB, thus, may cause them dearly in their reputation, as well as in their profits. Although they may improve after the recalls, they cannot compensate the loss in their reputation among partners and competitors from their subsequent acts every time a recall arrives. When home country institutions change according to foreign institutions, these firms are also likely to lose their positions in their domestic market. In sum, they also face a high probability of being eliminated by the marketplace governed by formal and informal institutional frameworks.

To illustrate this concept, we introduce Le Qu Toys as our example. Le Qu Toys was a family owned company established in 1987 in Dongguan, Guangdong Province. Gam-gwan Dang, owner of the company, built Le Qu from scratch. By producing toys for foreign companies and developing its own brands, Le Qu became the third largest toy manufacturer in Dongguan. Different from Lee Der, Le Qu had its own design team and was able to produce its own brands, such as Di Qu intellectual toys. However, most of its profit was from its foreign importers. Also

different from Lee Der, Le Qu had been carefully following domestic institutions in manufacturing. Le Qu exported toys to the United States, Europe, and Africa, and enjoyed a good reputation among partners and competitors since the beginning of its establishment.

Dang was overwhelmed by the success of Le Qu. As a successful entrepreneur, he became a billionaire. He failed to anticipate the serious consequences that the recalls could bring to him and to Le Qu. In fact, he did not do much to prevent recalls from happening. In 2007, Le Qu also received recalls from Mattel. Le Qu was so vulnerable that it did not survive the recall due to a lack of experience, preparation, and sufficient working capital. It was also in 2007, Chinese government issue several regulations to standardize the toy manufacturing industry in China. This further diminished the possibility of survival for Le Qu. In early 2008, Le Qu filed for bankruptcy and Dang sold the properties of Le Qu afterwards.

Like many other toy companies in China, Le Qu failed to pay attention to foreign institutions. Although it had a long history of relationships with companies from around the world, it did not learn much from them about the institutional differences. Only after the recall arrived did Le Qu realize the importance of complying with foreign institutions. However, the late responses led to fatal consequences. Firms that adopt a defensive strategy, such as Le Qu, face the possibilities of losing legitimacy in IB. They may also become vulnerable when domestic institutional pressures become strong after foreign institutional pressures starting to assert influence. In summary:

Proposition 2: Firms that ignore the foreign institutions and respond passively to institutional pressures may lose their legitimacy in IB.

Proactive Strategy

Firms that value both domestic and foreign institutions are likely to adopt a proactive strategy. However, in our study, only a few firms in the Chinese toy industry adopt such a strategy. This is

partly due to the perceptions that these firms have towards global institutions. Another reason for firms not adopting this strategy may be the high cost for an individual firm to acknowledge the differences between domestic and global institutions (Kostova, 1999; Kostova and Roth, 2002; Kostova and Zaheer, 1999). Thus, the help from the domestic government may be important to help them adopt proactive strategy. If the government provides domestic firms the necessary knowledge about foreign institutions, especially when domestic institutions change because of pressures from foreign institutions, it may help shaping the understanding of institutional difference and development by firms in its economy. The more information an economy can provide to its domestic firms on foreign institutions, the higher the probability the domestic firms may consider those institutions when making strategic decisions. However, a firm can learn the institutional difference through other ways such as from their foreign partners or domestic competitors (Kostova and Zaheer, 1999). They can also learn from their experience gained from their previous recalls. Firms adopting a proactive strategy take advantage of these methods and pursue knowledge in foreign institutions by investigating continuously through different ways. These firms accept their responsibilities and comply with both home and host country institutions. Thus, they have a higher chance to maintain legitimacy under institutional pressures. In fact, they often act *before* recalls are announced. This not only gives them a first mover advantage, but also helps them to maintain legitimacy in the long term.

Early Light Industrial Co., Ltd. (ELI) is a case in point. ELI is a private company owned by Francis Choi, an entrepreneur in Hong Kong. Choi started the company in 1972. In 1983, he became one of the earliest entrepreneurs to establish factories in mainland China. After two decades of development, ELI became one of the largest toy manufacturers in the world, producing leading toys such as Snoopy.

ELI faced the same problem of excessive lead level as experienced by Lee Der. Also in 2007,

ELI received a recall from Mattel to withdraw 436,000 pieces of “Sarge” toy cars from the U.S. market. However, this did not become a disaster for ELI. In fact, the toys involved in this recall were not manufactured in ELI’s factories. Instead, they were made by ELI’s subcontractors.

Before the recall was announced, ELI had already found that problems might occur from the unstable quality of its paint suppliers. Different from Lee Der, ELI did not tolerate the problem. It made several moves to avoid future problems. First, ELI built new factories to integrate each process in toy manufacturing in 2005, far earlier than the 2007 recall happened. Then, it signed contracts with several subcontractors to deal with the increasing demand in the market to support its expansion. Only those that had good quality and high productivity were considered. In addition, ELI built its own inspection team to test hazardous elements and control quality of the toys it made.

However, there are still problems ELI could not control with limited resources—its subcontractors made mistakes too. This reveals to be the reason for ELI receiving recalls in 2007. After the recall, ELI realized that it needs to make itself less dependent on subcontractors in the future. As for the next move, ELI plans to reduce the percentage of production made by its subcontractor to 10 percent in 2008 and aims to use no subcontractors in the near future. Although domestic institutions in China changed when increasing numbers of recalls arrived in the Chinese toy industry from the United States, ELI did not suffer much.

For companies that value their responsibility and continuously improve themselves according to domestic and foreign institutions, they can often act before recalls happen and avoid possible loss ahead of crisis. Thus, these companies have a higher chance to maintain legitimacy under institutional pressures. In brief:

Proposition 3: Firms that comply with both domestic and foreign institutions and respond proactively to institutional pressures may maintain their legitimacy in IB.

As toy recalls increased, the Chinese government introduced several pieces of legislation to the industry, such as strengthening the standard of toy manufacturing and enhancing the product inspections. The reason for the Chinese government's actions under pressures from U.S. institutions reveals that institutions from a host country may influence home country's institutions. Thus, even if domestic firms that ignore foreign institutions may stay in their domestic market for a while after they lose their positions in IB, they may still be forced out from the domestic market when changes in home country institutions take place according to foreign institutional pressures. Thus firms active in IB but remain domestically need to take into account both domestic and foreign institutions and consider the interaction between both countries' institutions.

DISCUSSION AND CONCLUSION

Overall, this article contributes to the literature by documenting the diverse strategic responses to institutional pressures from home and abroad, a missing gap in research on the institution-based view. Grown out of research in developed economies (Dacin et al., 2002; Oliver, 1997), the institution-based view has resonated especially well with the realities of emerging economies (Li and Peng, 2008; Meyer et al., 2008; Peng et al., 2008; Wright et al., 2005). By extending the strategic response framework (Clarkson, 1995; Oliver, 1991) in IB, we have found support for the framework from the Chinese toy industry. When firms actively participate in IB while remain domestically within their home country, they need to consider institutions from both home and abroad. The framework we have brought forth explains the mechanism between firms' strategic choices and institutional pressures from home and abroad. When firms need legitimacy in the environment to survive, they have to accept their responsibility of conforming to both formal and

informal institutions from home and abroad. In addition, they need to consider strategies they can adopt to change their destiny before pressures come by adapting themselves with the changes in institutions (Child, 1997; Flier et al., 2003).

Linking both developed and emerging economies, firms in the Chinese toy industry help us better understand the strategic response framework. Firms in IB need to attach importance to both domestic and foreign institutions when conducting business in a global market. Firms involved in recalls released by CPSC need to consider the pressures that recall announcements, as the formal institutions from outside their country, may cost them. Both U.S. firms and their Chinese suppliers need to take these announcements seriously. Although the reason for announcing a recall may not always be the problem stemming from the Chinese firms (Bapuji and Beamish, 2007), they still need to pay attention to the consequences for not responding effectively. Firms are not alone in the supply chain. They need to interact with other firms as well as different institutions to maintain legitimacy and achieve success. To gamble as a lot of Chinese toy manufacturers do is not a sustainable way to do business in such a global economy in the long run. This is especially important for Chinese toy exporters that depend on their stakeholders, as well as global institutions for survival. In order to cope with the pressures from home and host country institutions, our illustrations clearly advise that firms need to use a more proactive strategy to avoid possible negative consequences.

Our exploratory study can clearly benefit from future work. Theoretically, the strategic response framework we have articulated can benefit from closer integration with the resource-based view (Barney, 1991; Oliver, 1997; Meyer et al., 2008; Peng, 2001). Obviously, different strategic responses call for different capabilities (Yang and Li, 2008; Zhou and Li, 2007). A historically passive firm, even when realizing the necessity for a more proactive strategy, may simply fail in its implementation of a proactive strategy due to a lack of crucial organizational

capabilities. Empirically, more progress can be made along at least three dimensions. First, within the context of the Chinese toy industry, in-depth case studies and larger-scale quantitative work can build on this article. Second, we can study how firms from developed economies respond to changes in emerging economies to see if there are any differences between firms from either of the economies. Third, we can compare the strategic responses by domestically based firms in IB with strategic responses by MNEs. In addition, we can also consider the transitions in the institutions to see how firms respond over time.

In conclusion, the problem confronting participants in the Chinese toy industry is not a toy problem. If companies have the foresight and capabilities to adopt a proactive strategy, they may gain a better position in dealing with institutional pressures (Peng, 2009). As more restraints institutions bring to the global market, more research needs to be conducted on how firms in one country strategically respond to pressures stemming from institutions from both home and abroad.

Notes

1. Source for Lee Der Toy Company: Southern Metropolis Daily, CNN reports.
2. Source for Le Qu Toys: China Central Television (CCTV) reports, company website (www.lequ.com).
3. Source for ELI: Southern Metropolis Daily, CNN reports, Forbes reports.

References

- Bapuji, H., and P. W. Beamish. 2007. "Toy Recall: Is China Really the Problem?" *Canada-Asia Commentary*, 45:1-8.
- Bapuji, H., and P. W. Beamish. 2008a. "Mattel and the Toy Recalls (A)." Ivey Teaching Case (9B08M010), University of Western Ontario.
- Bapuji, H., and P. W. Beamish. 2008b. "Mattel and the Toy Recalls (B)." Ivey Teaching Case (9B08M011), University of Western Ontario.
- Barney, J.B. 1991. "Firm Resources and Sustained Competitive Advantage." *Journal of Management* 17:

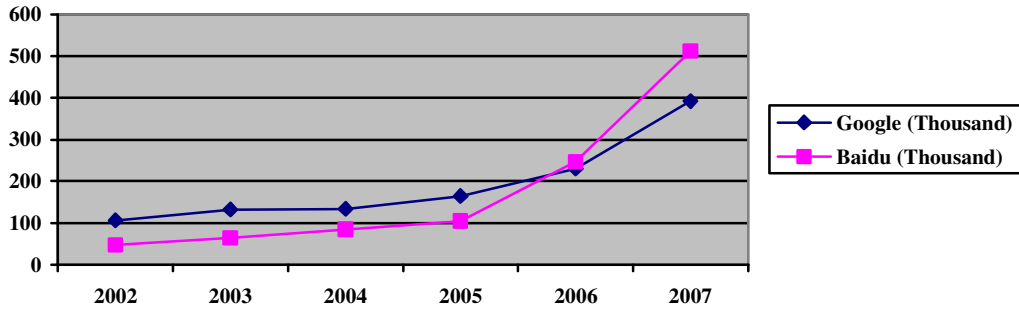
99-120.

- Carroll, G. R., J. Delacroix, and J. Goodstein 1988. "The Political Environments of Organizations: An Ecological View." In *Research in Organizational Behavior*, ed. B. M. Staw and L. L. Cummings, 359-352. Greenwich, CT: JAI Press.
- Child, J. 1997. "Strategic Choice in the Analysis of Action, Structure, Organizations and Environment: Retrospect and Prospect." *Organization Studies* 18: 43-76.
- Child, J., and T. Tsai. 2005. "The Dynamic between Firms' Environmental Strategies and Institutional Constraints in Emerging Economies: Evidence from China and Taiwan." *Journal of Management Studies* 42: 95-126.
- Chung, C.C., and P.W. Beamish. 2005. "The Impact of Institutional Reforms on Characteristics and Survival of Foreign Subsidiaries in Emerging Economies." *Journal of Management Studies* 42: 35-62.
- Clarkson, M.B.E. 1995. "A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance." *Academy of Management Review* 20: 92-117.
- D'Aunno, T., M. Succi, and J.A. Alexander. 2000. "The Role of Institutional and Market Forces in Divergent Organizational Change." *Administrative Science Quarterly* 45: 679-703.
- Dacin, M.T., J. Goodstein, and W.R. Scott. 2002. "Institutional Theory and Institutional Changes." *Academy of Management Journal* 45: 45-57.
- Davis, M.S. 1971. "That's Interesting! Towards a Phenomenology of Sociology and a Sociology of Phenomenology." *Philosophy of the Social Sciences* 1: 309-344.
- Edelman, L.B., and M.C. Suchman. 1997. "The Legal Environment of Organizations." *Annual Review of Sociology* 23:479-515.
- Flier, B., F.A.J. Van Den Bosch, and H.W. Volberda. 2003. "Co-evaluation in Strategic Renewal Behavior of British, Dutch and French Financial Incumbents: Interaction of environmental Selection, Institutional Effects and Managerial Intentionality." *Journal of Management Studies* 40: 2163-2187.
- Gersick, C. 1990. "Revolutionary Change theories: A Multilevel Exploration of the Punctuated Equilibrium Paradigm." *Academy of Management Review* 31: 9-41.

- Greenwood, R., and C. R. Hinings. 1996. "Understanding Radical Organizational Change: Bringing together the Old and the New Institutionalism." *Academy of Management Review*, 22:1022-1054.
- Hafsi, T., and M. Farashahi. 2005. "Applicability of Management Theories to Developing Countries: A Synthesis." *Management International Review* 45: 483-511.
- Kogut, B. 1991. "Country Capabilities and the Permeability of Borders." *Strategic Management Journal* 12: 33-47.
- Kostova, T. 1999. "Transnational Transfer of Strategic Organizational Practices: A Contextual Perspective." *Academy of Management Review* 24: 308-324.
- Kostova, T., and K. Roth. 2002. "Adoption of an Organizational Practice by Subsidiaries of Multinational Corporations: Institutional and Relational Effects." *Academy of Management Journal* 45: 215-233.
- Kostova, T., and S. Zaheer. 1999. "Organizational Legitimacy under Conditions of Complexity: The Case of the Multinational Enterprise." *Academy of Management Review* 24: 64-81.
- Meyer, J., and B. Rowan. 1977. "Institutionalized Organizations: Formal Structure as Myth and Ceremony." *American Journal of Sociology* 83: 340-363.
- Li, Y., and M.W. Peng. 2008. "Developing Theory from Strategic Management Research." *Asia Pacific Journal of Management* 25: 563-572.
- Meyer, K.E., S. Estrin, S. Bhaumik, and M.W. Peng. 2008. "Institutions, Resources, and Entry Strategies in Emerging Economies." *Strategic Management Journal* (in press).
- Oliver, C. 1991. "Strategic Responses to Institutional Processes." *Academy of Management Review* 16: 145-179.
- Oliver, C. 1997. "Sustainable Competitive Advantage: Combining Institutional and Resource-Based Views." *Strategic Management Journal* 18: 697-713.
- Peng, M.W. 2001. "The Resource-Based View and International Business." *Journal of Management* 27: 803-829.
- Peng, M.W. 2003. "Institutional Transitions and Strategic Choices." *Academy of Management Review* 28: 275-296.

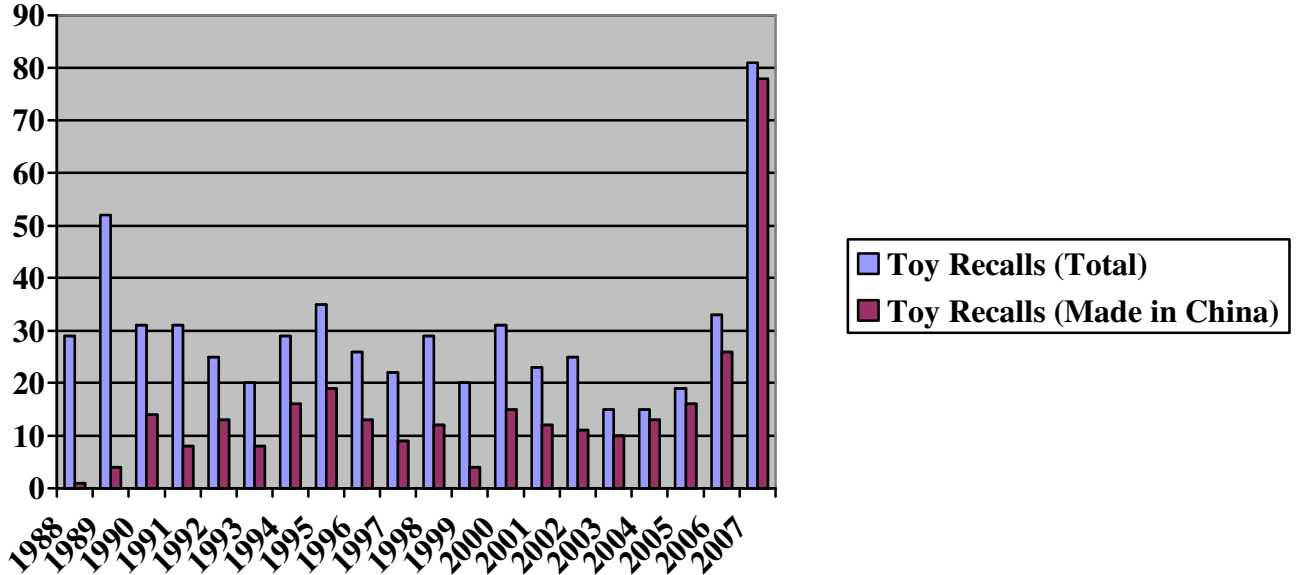
- Peng, M.W. 2006. *Global Strategy*. Cincinnati: South-Western Thomson.
- Peng, M.W. 2009. *Global Business*. Cincinnati: South-Western Cengage Learning.
- Peng, M.W., and T.A. Khoury. 2008. "Unbundling the Institution-Based View of International Business Strategy." In *Oxford Handbook of International Business*, ed. A. Rugman. Oxford, UK: Oxford University Press.
- Peng, M.W., D. Wang, and Y. Jiang. 2008. "An Institution-Based View of International Business Strategy: A Focus on Emerging Economies." *Journal of International Business Studies* 39: 920-936.
- Scott, W.R. 2001. *Institutions and Organizations*, 2nd ed. Sage: Thousand Oaks.
- Sherer, P.D., and K. Lee. 2002. "Institutional Changes in Large Law Firms: A Resource Dependency and Institutional Perspective." *Academy of Management Journal* 45: 102-119.
- Smith, D.C. 2001. "The Importance and Challenges of Being Interesting." *Journal of the Academy of Marketing Science* 31: 319-322.
- Tolbert, P.S., and L.G. Zucker. 1983. "Institutional sources of Change in the Formal Structure of Organizations: The Diffusion of Civil Service Reform, 1880-1935." *Administrative Science Quarterly* 28: 22-39.
- Wright, M., I. Filatotchev, R.E. Hoskisson, and M.W. Peng. 2005. "Strategy Research in Emerging Economies: Challenging the Conventional Wisdom." *Journal of Management Studies* 42: 1-33.
- Xu, D., and O. Shenkar. 2002. "Institutional Distance and the Multinational Enterprise." *Academy of Management Review* 27: 608-618.
- Yang, G.Y., and J. Li. 2008. "The Development of Entrepreneurship in China." *Asia Pacific Journal of Management* 25: 335-360.
- Zhou, K.Z., and C.B. Li. 2007. "How Does Strategic Orientation Matter in Chinese Firms?" *Asia Pacific Journal of Management* 24: 447-466.

Figure 1. Recall Related News (2002-2007)



Sources: www.google.com (English), www.baidu.com (Chinese).

Figure 2. Number of Toy Recall Announcements in the United States (1988-2007)



Source: www.cpsc.gov.

Figure 3. Pressures on Chinese Toy Manufacturers

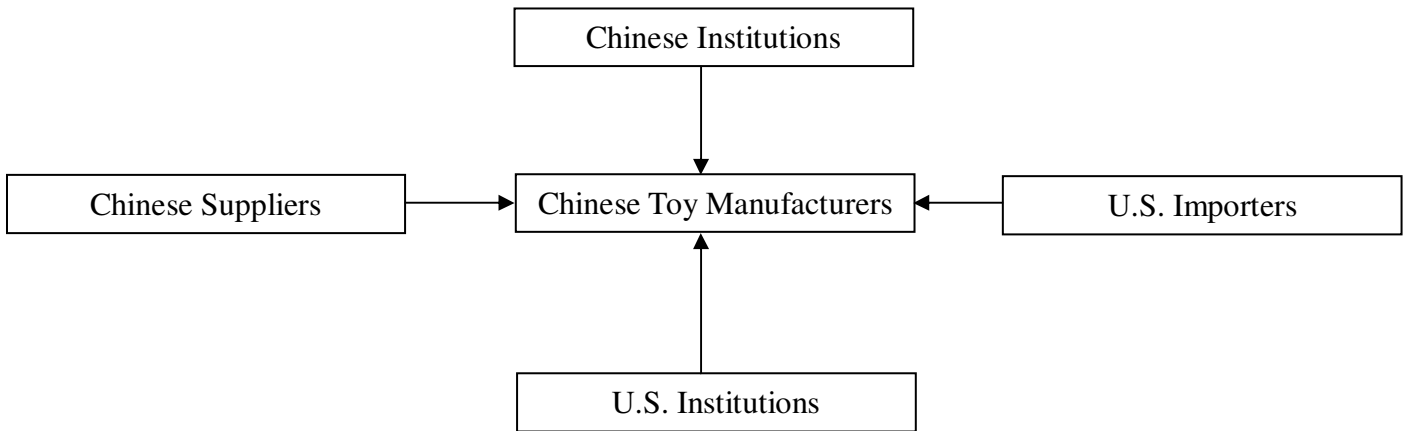


Figure 4. A Strategic Response Framework

	Deny Responsibility	Accept Responsibility
Act after Recall	1. Passive	2. Defensive
Act before Recall	4. *	3. Proactive

* Our case research did not uncover any firm in this cell.