INDUSTRIALIZATION OVER THE PAST HALF-CENTURY HAS ENABLED CHINA TO BECOME AN UNDENIABLE MANUFACTURING POWERHOUSE. HOWEVER, YEARS OF RELAXED REGULATIONS COUPLED WITH COST-DRIVEN BUSINESS PRACTICES THROUGHOUT THE NATION HAVE LED TO SEVERE ENVIRONMENTAL ISSUES; SO SEVERE THE GOVERNMENT HAS NOW TAKEN AGGRESSIVE ACTION IN POLICING THE ENVIRONMENTAL PRACTICES OF MANUFACTURERS.

Perhaps the biggest concern has been the poor air quality in China. Beginning in 2013, the Chinese government began to target pollution with its “Atmospheric Pollution Prevention Action Plan,” seeking a reduction in harmful particulates in an effort to improve air quality to certain benchmark levels through 2017.1

While the regulations did have a positive impact, the country seeks to further the policy of balancing economic growth with environmental preservation. China’s government has now turned to manufacturers in an effort to better preserve its natural resources for future generations. This commitment was detailed in Chinese President Xi Jinping’s January 2017 keynote speech at the United Nations in Geneva, as he spoke of his vision for China’s responsibility as related to its environment:

“We must not exhaust all the resources passed on to us by previous generations and leave nothing to our children or pursue development in a destructive way. Clear waters and green mountains are as good as mountains of gold and silver. We must maintain harmony between man and nature and pursue sustainable development.”2

By the end of 2017, Chinese manufacturers would experience some of the most widespread shutdowns in recent history due to government intervention.

Surprise plant inspections often result in fines and factory closures pending compliance with environmental regulations. The impact on Chinese manufacturers has been profound, with more than 14,000 factories closed in 20173, causing supply chain issues that have continued into 2018.
In recounting the impact on supply chains during 2017, one can see where how heightened regulatory enforcement has impacted various industries.

- Widespread factory closures impacted numerous provinces across the country, even companies already in compliance, as other manufacturers in their supply chains were closed for non-compliance.
- Lack of transparency concerning policy details caused factories to be unaware of the precise policies with which they need to comply, and upon shut down, a lack of transparency in the steps and timeline for resuming production activities.
- Affected sectors include those engaged in production activities labeled “environmentally impactful,” such as die-casting, painting, and printing, in addition to textiles, rubber, leather, chemicals, carbon, metal coating, and plastics.4

Speaking with those in industries in the Unites States reliant on Chinese manufactured goods has yielded similar concerned responses. For example, a wholesale distributor of telecommunications and utility hardware heavily reliant on China for production has found nickel plated products in particular have seen dramatic increases in price (upwards of 400%). While the company strives to diversify supply lines where possible, China remains the primary producer of goods in the industry and the costs are often passed on to customers.

Another company in the chemical distribution industry has found cost increases are affecting business. Fortunately for this wholesaler, the price increases resulted in improved performance as passing on the higher costs to customers has afforded an opportunity to garner improved profits in an environment driven by sales volume. For a business reliant on China for goods production, considering the direction and impact of China’s regulatory enforcement and enhancement in the near and long-term are essential.

Based on a two day conference in Beijing ending on May 19, 2018, it is reasonable to believe China will continue to take an aggressive position on the enforcement of environmental regulation.5 Additionally, considering China has removed presidential term limits, the political environment in China will likely remain stable with the same commitment for the foreseeable future.

In order for companies engaged in business with Chinese manufacturers to minimize risks associated with regulatory enforcement, the following should be contemplated:

1. Consider the inspection history of a manufacturer. The Ministry of Ecology and Environment (a department of the State Council of the People’s Republic of China) is China’s government body empowered to enforce the environmental laws and policies in effect. Obtaining the results of inspections/audits performed by the Ministry may serve as an indicator of the factory’s compliance with regulations, along with its relationship with oversight authorities.

2. When possible, a site visit should be conducted where checking the facility first hand may provide insight into the practices at the facility.

3. Consider the current clientele of the manufacturer; those with renowned clients are likely to have undergone scrutiny in satisfying the sourcing demands of such marquee brands. Looking to those manufacturers already supplying well-known customers may provide comfort that the manufacturer takes an aggressive approach to compliance with regulations, thereby mitigating risk of a government imposed shutdown.

4. Perform extensive due diligence, including a robust search using social media. Not only is this an inexpensive way to obtain information about a prospective business partner, some social media groups are useful to obtain feedback on real experiences in the industry.

5. Consider seeking out a sourcing agent. While the services will come at a cost, a strong sourcing agent will bring value to the due diligence process as they are able to leverage years of experience in sourcing production from quality manufacturers. Agents may offer a variety of services including background verification, inspection, quality control, factory audits, and other risk management services. Choosing a reputable sourcing agent as a partner is paramount if relying on such services in aligning with Chinese manufacturers, as one can only expect the factory to be as good as the agent.

Chinese environmental regulations are here to stay and will likely become even stronger. Chinese manufacturers will undoubtedly be affected in one way or another; through direct fines and forced closures, or indirectly via problems in the supply chain. Manufacturers will have to navigate the change in political environment as they seek to meet the regulations imposed through implementing the appropriate measures to conform to environmental standards. While Chinese manufacturing companies are entering a new normal, companies across the globe seeking low-cost manufacturing need to carefully consider when aligning with manufacturing partners. To forego contemplating the basic considerations related to compliance with environmental regulation is to invite possible disruption in the supply chain. Appropriate due diligence is a must in avoiding such risks.

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