

September 30, 2007

The party's over in China. Or is it?

We first learned about problems in China this year when we heard that dog and cat food was contaminated with aminopterin, which causes crystals to be created in the tiny tubes of the kidneys, plugging and damaging them and causing kidney failure. http://www.usatoday.com/news/health/2007-03-25-pet-food-scare_N.htm

A couple of months later we learned about toothpaste contaminated with diethylene glycol (antifreeze). Hu Keyu, a manager at Goldcredit International, said that most toothpaste makers in the region continued to use diethylene glycol because it was considered a cheap substitute for glycerin. "You know, if you're in the export market, the margins are small, so people use the substitute," Hu said. "Even one percent or half a percent price difference can matter to people here."

<http://www.iht.com/articles/2007/05/22/business/paste.php>

More recently in early September, Mattel recalled 800,000 toys contaminated with lead paint, all from China. The Consumer Product Safety Commission, which is responsible for inspecting hundreds of millions of truckloads of products imported into the U.S., is hampered by a shrinking, demoralized staff of only 15 inspectors for the entire nation. The agency is particularly weak because it has a very limited ability to fine companies that withhold information about a recalled product. Mattel has been accused of doing this at least twice.

http://www.consumeraffairs.com/news04/2007/09/mattel_recall2.html

Even Thomas the Train has recently been found to contain lead paint! So what's the problem here? Not enough control by the manufacturers? A demand for cheap products? Not enough regulators? Not enough inspection by the importers themselves? Yes, yes, yes. Yes.

A brief history

US manufacturers found they could save money by outsourcing their production overseas, starting with industrial products such as steel, chemicals and building materials. As Asia and other third world countries gained the ability to manufacture more sophisticated products, they became the major sources for many consumer products, from electronics to automobiles to garments. As Americans acclimated to low prices they demanded better quality and even lower prices. To meet the demands of the consumers, companies both in the US and abroad found ways to cut costs, in many cases at the expense of quality. It didn't really matter too much because America's appetite for cheaper goods was so great, they would overlook quality for bargains, as epitomized by the Wal Mart model.

The process gained so much momentum that companies threw quality to the wind in their attempt to reduce costs, sell as much as possible and satisfy the American appetite. As the proverbial straw that broke the camel's back however, the entire cycle of low prices/decreased quality/greed (as practiced by both consumers and manufacturers) has been broken by something more important to Americans - safety.

In addition to cheap prices, Americans also want to live safe lives. Simply look at all the safety related features in automobiles, houses, baby car seats, strollers, bicycle helmets, office buildings and couple them with the huge increase in regulatory costs in the country (regulation costs \$1.1 trillion per year in the US - www.cei.org/gencon/025,06018.cfm) and it's easy to see how important safety is to Americans. Unfortunately cheap prices and increased safety are not compatible; safe products cost more to produce but if the prices are diminishing the safety has to diminish proportionally.

That is what has happened to goods from China and other sources – maintaining low prices has resulted in products that have lower quality and compromised safety. In a way, Americans got what they asked for. However, the need for safety will supersede the demand for low prices and manufacturers will respond by sacrificing low prices for increased safety.

They will use better materials, perform more testing, both at the site of the manufacturer and the site of the importer, and the government will impose more regulations on all products. The end result will be that companies will

spend more to produce safer products and will pass the costs onto consumers, who will grumble about the higher costs but will pay for security.

Even though the party is almost over in China, the Chinese are entrepreneurs who will find a way to reverse the situation by recreating their businesses to meet the needs of the American consumer. This leaves a small window of opportunity for US manufacturers who currently apply stringent controls to their processes to promote themselves as long term “quality” companies who have already been using high standards of sourcing, manufacturing and testing to build better products that the consumer can feel secure in buying. These high quality companies can advertise their superiority and can even host the worldwide product party for a while. The bottom line is that in order to take advantage of this opportunity they must retain their great employees to get the job done.