



Editors' Forum – Made in China: Implications of Chinese Product Recalls

Editor's Introduction – No Free Lunch: Dilemmas of Product Quality in China

Marshall W. Meyer

University of Pennsylvania, USA

ABSTRACT This Editors' Forum – 'Made in China: Implications of Chinese Product Recalls' – presents four perspectives on Chinese product recalls: supply chain management, moral degradation or the decline of traditional business ethics, evidence based management and free riding on the 'Made in China' brand. Extended supply chains and uncertain ethical standards almost certainly contribute to lapses in product quality as do cost pressures facing most Chinese firms. Product quality issues, moreover, will be most significant for goods posing hidden risks to health and safety, such as food and toys, and less significant for goods like computers and consumer electronics whose conformity to specifications can be readily monitored.

KEYWORDS business ethics, China, product quality, supply chain management

INTRODUCTION

Recalls of Chinese products ranging from pet food to toothpaste, tires, toys and pharmaceuticals have tarnished China's image as a manufacturing powerhouse. In response, the Chinese government launched a massive 'Made in China' campaign featured on China Central Television (CCTV). 'This is a special battle to protect the interest and health of the masses, the prestige of Chinese products and our nation's image,' Vice Premier Wu Yi declared on August 23, 2007 (Lawrence, 2007). The news has not improved since. For example, on April 22, 2008, *The New York Times* reported, 'A contaminated blood thinner from China has been found in drug supplies in 11 countries and federal officials said Monday they had discovered a clear link between the contaminant and severe reactions now associated with 81 deaths in the United States' (Harris, 2008).

What has happened? Some, of course, will say nothing except greater scrutiny of Chinese goods as her export prowess has grown. Others, however, believe

something has happened but disagree as to what it is. This Editors' Forum on the Implications of Chinese Product Recalls introduces four groups of experts who have provided thoughtful discussions on this issue. These four sets of scholars offer perspectives mostly mirroring popular views. Two of the articles in this Forum argue implicitly if not explicitly that the quality of Chinese goods has deteriorated. Marjorie A. Lyles, Barbara B. Flynn and Mark T. Frohlich suggest that ever lengthening supply chains from Chinese producers to overseas markets create obstacles to product quality. Yadong Luo presents a demoralization perspective where the loosening or disappearance of traditional Chinese commercial ethics, a form of anomie, has led to an exclusive focus on ends – principally wealth. The other two articles in this Forum claim, again implicitly if not explicitly, that little has changed. Paul W. Beamish and Hari Bapuji focus on the toy industry, asserting, first, that the recall problem lies mainly in the design, largely overseas, of Chinese-made toys, rather than in their manufacture and, second, that the likelihood of product recalls is no greater for Chinese manufactured toys than for toys manufactured elsewhere. And finally, Jay B. Barney and Shujun Zhang believe that product recalls reflect endemic 'free riding' on the 'Made in China' brand promising low cost and satisfactory quality; the proposed antidote is mutual monitoring by manufacturers and enforcement of laws protecting intellectual property, both of which would be novel developments in China.

In this essay, I will summarize the core arguments of the four authors, point out their key contributions, question faulty assumptions and, in some instances, punctuate abstract arguments with facts. My viewpoint, developed in the course of reading the four essays, is that the quality problem arises from the combination of: (i) supply chain dynamics that are exacerbated in China due to extensive subcontracting; (ii) normlessness or anomie arising from legal and regulatory institutions lagging behind the growth of the Chinese economy; and (iii) cost pressures fueled by the rise of the Chinese RMB and domestic inflation. None of these factors is fully within the control of foreign or domestic firms sourcing in China. However, firms doing business in China can exercise greater control of their supply chains and require suppliers to implement quality programs. Still, some difficult tradeoffs are ahead. For example, shifting from coastal to inland sources firms can help control labour costs but will further complicate supply chain dynamics. The bottom line, also the title, is that there is no free lunch.

FOUR EXPLANATIONS OF PRODUCT RECALL IN CHINA

'All Supply Chains Don't Flow Through: Understanding Supply Chain Issues in Product Recalls'

Lyles, Flynn and Frohlich's take on China's product recall problem should draw the attention of many social scientists. Supply chains are not new to researchers in

operations management. Social scientists, however, have traditionally looked at group structures, whether or not networks or hierarchies, rather than chains of transactions, even though the latter have arguably become the dominant organizational form of global business. As Lyles et al. point out, long supply chains can have unanticipated behavioural consequences. For example, the longer the chain, the more critical knowledge transfer is to effective performance, yet the more knowledge transferred upstream, the greater the power of suppliers. Further, the longer the supply chain and the greater the cultural gap between partners, the more likely it is that the significance of order winners – usually low price – will be magnified and that of order qualifiers – quality standards – diminished. Additionally, lengthy supply chains suffer the Bullwhip effect ‘with the downstream end-customer’s growing amplitude having devastating effects on upstream supply chain partners’ (2008, p. 175). Since supply chains tend to be longer in China than elsewhere due to extensive subcontracting or *cheng bao*, trust is critical but is hardly a free good: typically, supply contracts go to firms based on experience, which means that buyers and sellers are locked into each other. Alternatively, as Lyles et al. point out, buyers and sellers can engage third party assessors or they can move toward integration of their processes, neither cost free. Lyles et al. make a convincing case that distance is alive, well and expensive, rumours of the ‘death of distance’ notwithstanding (Boisot & Meyer, 2008).

Lyles et al. suggest several avenues for research. One involves detective work: what has gone wrong in China and why? Another is more analytical and probes issues like creating and maintaining visibility and trust in supply chains – each is the complement of the other – and optimal supply chain depth needed for different products and markets. The last point is important because the tradeoffs between labour costs and supply chain costs may differ across products and markets. The acknowledgement of such tradeoffs, however, raises the question of whether or not massive product recalls signal overextension of global supply chains, possibly presaging a retreat from globalization. Finally, of equal importance is Lyles et al.’s meta-message: management practices in China reflect supply chain dynamics and costs, the latter very high in comparison with global benchmarks (Meyer, 2008). Scholarship on Chinese management will require more than passing familiarity with supply chain and logistics issues in China.

‘A Strategic Analysis of Product Recalls: The Role of Moral Degradation and Organizational Control’

Yadong Luo minces no words. ‘Moral degradation,’ he argues, is a possible underlying explanation for massive product recalls from China, which ‘is moving toward a society with weakened morals’ (2008, p. 185). Ends, economic ends especially, have taken precedence over means. The consequence is the pursuit of wealth at any cost, including poor product quality and lax safety standards.

Corollaries of moral degradation include poor contractual governance and short-sighted leadership. Contracts are overlooked as soon as they are crafted and long-term reputational benefits of quality and safety lapses are discounted nearly to zero. Luo recommends a number of actions for the Chinese government and industry. For the government, these actions include tighter regulation and strengthened trade associations; for firms, the most important step is supplier accountability and indemnification for recalls.

Luo directs his most actionable recommendation toward social scientists when he calls for the extension of anomie theory to product quality and recalls. The specific questions include whether or not an association exists between the level of anomie in society and the frequency of product recalls; whether or not the threat of legal sanctions averts recalls, the level of anomie withstanding; whether or not a firm's reputation domestically and internationally limits the frequency of recalls; and whether or not other firm level actions like training in quality and mandatory compliance programs limit recalls. Luo, importantly, is not arguing that anomie in society can be reduced, certainly not in the short run. Rather, he limits his recommendations to steps firms can take to mitigate the effects of anomie. I am not certain that Luo should have been so circumspect. On the one hand, Luo does not fully explain why the untrammelled pursuit of wealth has displaced traditional values. Have all emerging economies had this experience? Or is anomie especially prevalent in China due to the lingering effects of the Cultural Revolution when many traditional bonds were shattered? In contrast, will firms or will the government and the educational system be best able to address moral degradation by persuading the Chinese people that honest and transparent business dealings yield the greatest gains for all?

'Toy Recalls and China: Emotion vs. Evidence'

Beamish and Bapuji's essay is subtitled 'Emotion vs. Evidence'. Their concern is that sentiment against Chinese made products may be misplaced; their argument is that proper attention to the evidence would mute unwarranted criticism of manufacturing practices in China: 'It would be useful . . . to separate emotions from reality and to understand the role of cognitive biases for attributions of responsibility and emotional reactions' (2008, p. 207). My reading of this essay is somewhat different. I find it a demonstration of how careful we must be in drawing strong conclusions from seemingly incontrovertible quantitative evidence; I also find it a demonstration of the importance of testing assumptions against first-hand knowledge, that is, direct observation of the phenomenon under study.

Beamish and Bapuji's evidence is straightforward and seemingly incontrovertible. Toy recalls have increased sharply since 2004; recent recalls are mostly of Chinese made toys since China now dominates the toy market; design flaw recalls greatly outnumber recalls due to flaws in manufacturing; a higher percentage (by

dollar value) of non-Chinese toy imports than of Chinese toy imports have been recalled for both design and manufacturing related flaws. Beamish and Bapuji also claim the methodological if not the moral high ground: 'In this research, we explored the phenomenon by using evidence and data in a systematic way . . . a deep and systematic description of the phenomenon is a necessary step preceding the generation of theory to explain it' (2008: p. 207).

However, how systematic were Beamish and Bapuji? The concern is how carefully they tested two assumptions critical to their argument. The first is that Chinese suppliers do not design the toys they manufacture: 'Chinese suppliers are only involved in manufacturing the toys and not in designing them' (2008, p. 202).^[1] Beamish and Bapuji's visits to Chinese factories found 'negligible evidence of major design activity'.^[2] However, many Chinese toy factories manufacturing for export claim ODM or original design manufacturing capabilities. A Google search for 'ODM toys China' yields about 270,000 hits. A search for 'original design manufacturing toys China' yields over 1 million hits. The second assumption is that the design and manufacturing stages of production can be cleanly separated since designs are often altered to meet manufacturing requirements. In fact, Beamish and Bapuji spoke with manufacturing engineers in Chinese toy factories and found that minor design changes were made to meet manufacturing requirements 'with the agreement of the foreign company for which they were manufacturing'.^[3]

I've not visited Chinese toy factories, but I recently visited their next of kin, a factory manufacturing small kitchen appliances such as toasters, tea kettles, coffee makers and hand mixers. The factory is named Donlim; it is located in Foshan City, Guangdong Province, and is an OEM/ODM producer manufacturing entirely for export. The design studio is not large, but it is active. Most importantly, several award winning Donlim designs are on display, including the steam iron shown in Figure 1. The small type on the trophy says, 'Excellent Prize, China 2007 Red Star Design Award.' I didn't speak with manufacturing engineers at Donlim, but several years ago I did at an electronics factory supplying an MNC in the China–Singapore Suzhou Industrial Park. The gist of the conversation was, 'We change their designs all the time,' and the manufacturing engineers, all Chinese, sent me their published papers to prove the point.

Beamish and Bapuji add value by demonstrating that the frequency of recalls is about the same for toys manufactured in China and elsewhere – in other words, China is not particularly bad (or particularly good) at manufacturing toys in the current economic climate. However, I think they underestimate the design capabilities of Chinese manufacturers, inadvertently contributing to the stereotype that China can manufacture but not design. Their analysis also does not show sufficient sensitivity to the interactions between onsite manufacturing engineers and offsite design engineers in determining final product design. These interactions are critical because as the quality of manufacturing engineers – all Chinese in Chinese factories – improves, they will have a greater say in final design decisions.

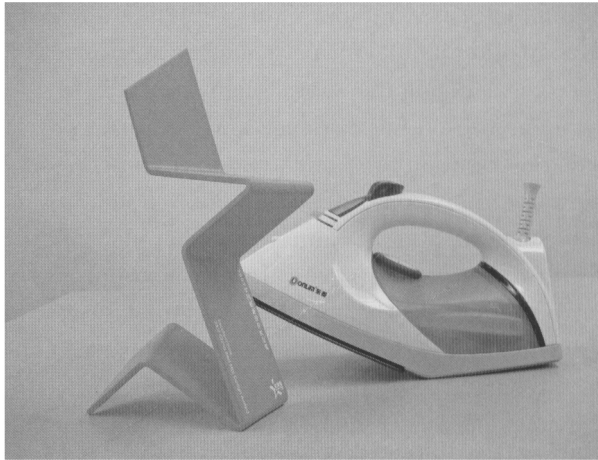


Figure 1. Award winning design for household steam iron (Photograph by Marshall W. Meyer)
Note: Trophy says, 'Excellent Prize, 2007 China Red Star Design Award'.

'Collective Goods, Free Riding and Country Brands: The Chinese Experience'

The idea of country brands is hardly new.^[4] However, Barney and Zhang treat country brands as collective goods susceptible to free riding when individual firms fail to deliver on the promise implicit in the brand. The assumption is that a country brand, once established, permits a firm to impair the quality of its products to its advantage, at least in the short run. In the case of China, the country brand promises low cost and good value or average quality (2008, p. 212). Free riding occurs when a firm tacitly or explicitly embraces the country brand while compromising the value or quality of its products. Normally, the corrective action to free riding is policing or, more politely, monitoring firms' behaviour. The government, for example, can police quality. However, policing is costly. And the police can be corrupted: the July 2007 execution of State Food and Drug Administration head Zheng Xiaoyu for accepting bribes to approve a lethal antibiotic is a case in point. Alternatively, trade associations can police the conduct of their members. However, Barney and Zhang believe that Chinese trade associations are 'generally run by the government' (2008, p. 217) and, hence, are incapable of mutual monitoring. Barney and Zhang then explore alternatives to the low cost leadership strategy of Chinese firms. Citing the experience of Japan and, more recently, Korea, they suggest that China might be able to differentiate its goods and move from low cost–good value/average quality to a position of high quality–higher cost, provided several hurdles could be cleared. These include developing skill sets more sensitive to quality and implementing effective intellectual property protection.

A concern is whether or not concepts of country brand as a collective good and free riding are needed to explain quality lapses in some sectors of Chinese industry.

A simpler explanation might be that quality lapses occur where costs are rising yet the market will not bear price increases. The US airline industry is illustrative – are the airlines free riding on the ‘Made in America’ brand or are they allowing service quality to deteriorate in response to dramatically increased fuel costs? Costs are rising in China. The RMB has appreciated about 16 percent against the US dollar since the peg was dropped in 2005 and consumer prices rose 9 percent from February 2007 to February 2008.^[5] With the new employment law effective January 1, 2008,^[6] further labour cost increases can be anticipated, especially in regions like Guangdong where spot labour shortages have already occurred. At the same time, hyper-competition will remain endemic in China. The Chinese economy is highly fragmented, reflecting both historic patterns (Skinner, 1965) and local protectionism (Meyer, 2008). Chinese civil administration is highly decentralized and enforcement of quality standards and intellectual property laws is delegated to provincial and municipal officials more concerned with meeting local employment and GDP targets than maintaining quality. The consequence of economic fragmentation and administrative decentralization is that most firms remain small and are forced to operate on the technological frontier while not advancing it – in other words, products are undifferentiated and competition is on price. A fundamental re-engineering of China’s economy and administrative systems – not just upgraded labour force capabilities and vigorous enforcement of IP laws – may be needed for Chinese firms to grow organically, gain market power and shift from price to quality leadership.

CONCLUSION

Lyles et al. and Luo raise micro and macro questions about product recalls in China. The micro question is whether or not the extension of supply chains has led to a deterioration of product quality and, hence, recalls. The macro question is whether or not the degradation of social norms has also led to the deterioration of product quality, and, hence recalls. Beamish and Bapuji believe that the causes of deteriorating quality lie largely outside of China and that, in any case, recalls of toys are no more likely in China than elsewhere. And Barney and Zhang are tied to a free riding explanation of deteriorating product quality, which assumes the existence of a valued ‘Made in China’ brand; as mentioned, it may be that rising costs rather than free riding on the ‘Made in China’ brand offers a more succinct explanation for deteriorating quality. Collectively, these four essays provide some thought provoking accounts for the product quality problem in China. This problem will continue to plague China for some time to come given the challenge of enforcing laws in this massive economy and the slow pace of change in norms, values and business ethics in China as elsewhere. While these ideas are insightful, research is necessary to test these explanations, to the extent possible, simulta-

neously rather than separately by exploring whether or not product quality and product recalls are more sensitive to supply chain depth, costs, or moral degradation.

Finally, I believe that we should temper this discussion with the fact that four of the five largest categories of Chinese exports to the USA, computer equipment, communications equipment, apparel and audio and video equipment,^[7] have not been subject to highly publicized product recalls. Computer, communications and audiovisual equipment electronics are easily tested for conformity with specifications, and the quality of apparel is, in most instances, readily discerned by customers. Goods posing hidden risks to health and safety pose the greatest temptation to manufacturers in China and elsewhere; goods posing risks to vulnerable populations like children and the ill pose the greatest temptation to journalists. Again, lengthy supply chains, deteriorating social norms and increasing costs exacerbate these temptations. Researchers need to sort out which of these exacerbating factors operate with the greatest force for which classes of manufactured products and in which countries.

NOTES

This special forum corresponds with a keynote symposium at the 2008 IACMR Conference (June 19–22 in Guangzhou, China). *Management and Organization Review* will invite rejoinders from the authors for further discussion and debate of this issue.

- [1] Lyles et al. (2008, p. 169), by contrast, state, ‘*Usually* foreign firms design the product . . .’ (my italics).
- [2] Private correspondence from Paul Beamish, May 26, 2008.
- [3] Also private correspondence from Paul Beamish, May 26, 2008.
- [4] See, for example, the various indexes of FutureBrand, <http://www.countrybrandindex.com/>.
- [5] See the National Bureau of Statistics February, 2008, CPI indexes at http://www.stats.gov.cn/English/statisticaldata/monthlydata/t20080325_402470279.htm.
- [6] The full English translation of the new labor law can be found at http://en.wikipedia.org/wiki/China_Employment_Law.
- [7] See <http://www.fas.org/sgp/crs/row/RL33536.pdf>, Table 5, page 5.

REFERENCES

- Barney, J. B., & Zhang, S. 2008. Collective Goods, Free Riding and Country Brands: The Chinese Experience. *Management and Organization Review*, 4: 211–223.
- Beamish, P. W., & Bapuji, H. 2008. Toy Recalls and China: Emotion vs. Evidence. *Management and Organization Review*, 4: 197–209.
- Boisot, M., & Meyer, M. 2008. Which way through the open door? Reflections on the internationalization of Chinese firms. *Management and Organization Review*, 4: forthcoming.
- Harris, G. 2008. U.S. identifies tainted heparin in 11 countries. *The New York Times*, Apr 22. [Cited 26 Apr. 2008.] Available from URL: <http://www.nytimes.com/2008/04/22/health/policy/22fda.html?scp=3&sq=heparin&st=nyt>
- Lawrence, D. 2007. China begins four-month campaign to enhance quality (update 1). *Bloomberg*, August 24. [Cited 26 Apr. 2008.] Available from URL: <http://www.bloomberg.com/apps/news?pid=20601080&sid=aVzYIFyYGNiY&refer=asia>
- Luo, Y. 2008. A Strategic Analysis of Product Recalls: The Role of Moral Degradation and Organizational Control. *Management and Organization Review*, 4: 183–196.

- Lyles, M. A., Flynn, B. B., & Frohlich, M. T. 2008. All Supply Chains Don't Flow Through: Understanding Supply Chain Issues in Product Recall. *Management and Organization Review*, 4: 167–182.
- Meyer, M. W. 2008. China's second economic transition: Building national markets. *Management and Organization Review*, 4: 3–15.
- Skinner, G. W. 1965. Marketing and social structure in rural China: Part III. *The Journal of Asian Studies*, 24: 363–399.

Marshall W. Meyer (meyer@wharton.upenn.edu) is the Richard A. Sapp Professor of Management in The Wharton School as well as Professor of Sociology and Associate Member of the Center for East Asian Studies at the University of Pennsylvania. He holds a Ph.D. in sociology from the University of Chicago. His publications in *MOR* include 'Managing Indefinite Boundaries: The Strategy and Structure of a Chinese Business Firm' with Xiaohui Lu (*MOR* 1.1, pp. 57–86), 'China's Second Economic Transition: Building National Markets' (*MOR* 4.1, pp. 3–15), and 'Which Way through the Open Door? Reflections on the Internationalization of Chinese Firms' with Max Boisot (*MOR* 4.3, forthcoming).

Manuscript received: April 29, 2008

Final version accepted: May 5, 2008

Accepted by: Anne S. Tsui