



Using social and economic incentives to discourage Chinese suppliers from product adulteration[☆]

Christopher S. Tang^{a,*}, Volodymyr Babich^b

^a Anderson School of Management, UCLA, B517 Gold Hall, Los Angeles, CA 90095, U.S.A.

^b McDonough School of Business, Georgetown University, Hariri Building 531, Washington, DC 20057, U.S.A.

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Abstract The American public raised serious concerns about product safety in 2007, when the number of product recalls broke a new record. Following a temporary drop in 2008, both the number and retail value of recalled units have been increasing, despite various efforts exerted by government agencies and private companies to combat this trend. Currently, many countries—including China itself—are expressing serious concern over adulterated or unsafe food made or sold in China. What are the underlying reasons for some Chinese suppliers to adulterate product? When law enforcement is still weak in China, what can western manufacturers do to reduce the risk of product adulteration? To develop effective deterrence mechanisms, we first identify four underlying factors that create incentives for some Chinese suppliers to produce unsafe products. Then we propose ideas to discourage Chinese suppliers from producing adulterated products based on two underlying strategies: (1) creating economic incentives through contingent payments, and (2) creating a social incentive by threatening public exposure through the power of the Internet and social networking sites. © 2014 Kelley School of Business, Indiana University. Published by Elsevier Inc. All rights reserved.

1. Unsafe products and food items made in China

As more western firms outsource their production to foreign suppliers, price competition intensifies and

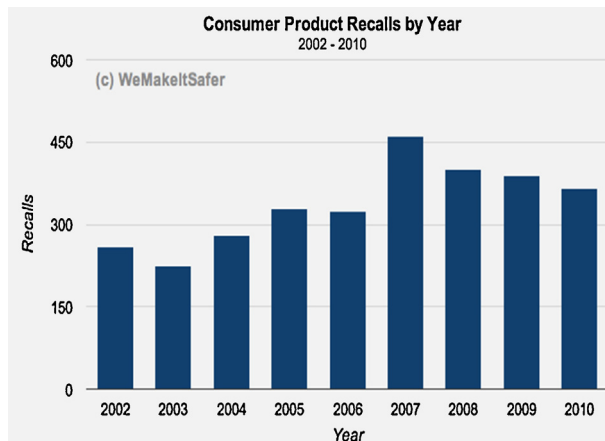
suppliers are under tremendous pressure to cut cost. Unfortunately, in response to this pressure, many foreign suppliers have reduced cost by lowering product quality. Some have even produced adulterated products (i.e., products that do not meet specification) that can cause physical harm. Product adulteration has become a common cause of many recent product recalls. In 2007, public concern about product safety reached an all-time high, with 472 product recalls. While suppliers in any part of the world may succumb to product adulteration, the problem has been particularly visible regarding

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* Corresponding author

E-mail addresses: chris.tang@anderson.ucla.edu (C.S. Tang), vob2@georgetown.edu (V. Babich)

Figure 1. Number of product recalls in the U.S. (2002–2010)

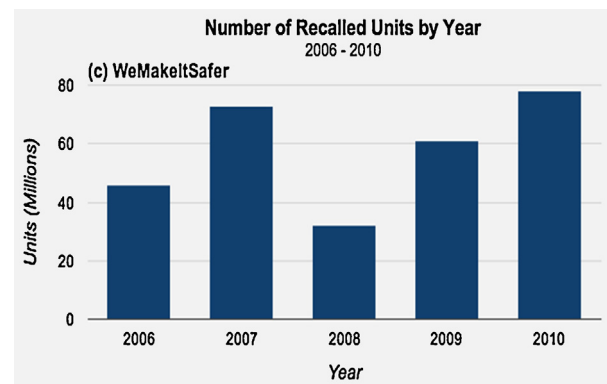


Source: www.wemakeitsafer.com

suppliers located in China. For example, to reduce cost and take advantage of loose scrutiny by the Chinese government, in 2007 Baxter's contract manufacturer Changzhou SPL used hypersulfated chondroitin sulfate—a cheap and unsafe substance—to produce an adulterated blood-thinning drug, Heparin. Following deaths and illnesses in the U.S., Baxter recalled Heparin in 2008 (Fairclough, 2008). Other recent examples include the recall of millions of adulterated Mattel toys, due to unapproved lead paint (Tang, 2008); the recall of hundreds of brands of adulterated pet food, due to melamine (Roth, Tsay, Pullman, & Gray, 2008); and the 2008 Chinese milk scandal involving milk and infant formula, also adulterated with melamine. Milk adulteration caused 6 deaths and 300,000 illnesses in babies in China (Martin, 2008). Between 2002 and 2010, the U.S. Consumer Product Safety Commission (CPSC) recalled more than 1,500 goods imported from China. In 2012 alone, the CPSC recalled numerous products: GE dishwashers and Kenmore dehumidifiers, due to fire hazards; baby strollers and highchairs, due to fall hazards; children's pajamas, due to fire hazards; and various toys, due to banned substances.

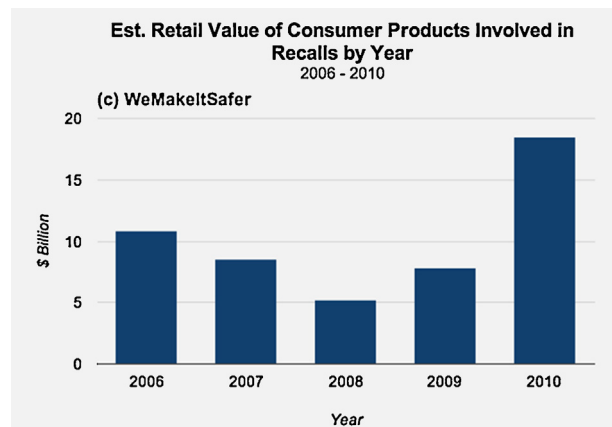
Although citizens in many countries, including China, are urging their governments to curb product adulteration, product adulteration and product safety violations continue to occur in large numbers. Figure 1 summarizes the number of product recalls, while Figures 2 and 3 summarize the number of recalled units and the corresponding retail value in the United States over the last few years. In 2012 alone, CPSC product safety inspectors managed to identify and halt over 650,000 unsafe Chinese products from entering the U.S.

Figure 2. Number of recalled units in the U.S. (2006–2010)



Source: www.wemakeitsafer.com

Figure 3. Estimated retail value of recalled units in the U.S. (2006–2010)



Source: www.wemakeitsafer.com

market. In 2011, most of the children's products stopped were denied entry due to unsafe or banned substances—including lead, phthalates, and cadmium—or small parts that can cause suffocation (Figure 4). Other general items included Christmas lights and electric appliances (fire/electric shock hazards) and shoes and furniture (banned substance dimethylfumarate, a mold-proof agent that can damage human skin).

The world's exposure to unsafe consumer products and food items made by Chinese companies has grown dramatically since China joined the World Trade Organization (WTO) in 2001. Many U.S. agribusinesses and food manufacturers source food ingredients from China even though—or maybe because—environmental, food safety, and labor laws are weaker and regulatory oversight is lax. In 2011, a non-governmental organization, Food and Water Watch, issued a report highlighting the

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