

The Cost of Green

In recent months, the Ministry of Environmental Protection has closed more than 30,000 Chinese manufacturing businesses over pollution regulations. Supply chains have fractured and customers left out in the cold. Welcome to the new normal: China's green future doesn't intend to take any dirty prisoners. – By Gina Miller

Environmental protection has long been a key concern for Hong Kong residents. Most residents are less concerned about the ecological impact pollution has on the endangered Romer's Tree frog (discovered in 1952 and native to Hong Kong only) than they are about developing asthma as a result of poor air quality; nevertheless improved environmental quality has long been on the wish list of Hong Kongers who desire a more liveable city. And China's countless factories, particularly in the south, were the devil that stood between HKSAR citizens and a breath of fresh air.

For those in the know, this perception of China as the (dirty) manufacturing centre of the world has been turned on its head. For several years, China has pushed for impressive environmental regulations that have outstripped North America in terms of regulatory aspirations. Environmental groups praise Xi's handling of China's new climate agenda, though many remain critical of industrial pollution.





While air quality targets may be dear to Hong Kong's heart, they are causing significant upsets for companies that rely on factories in China that have been recently hit (and closed) by the Ministry of Environmental Protection (MEP). In the past year, the MEP has closed thousands of factories, primarily in the provinces of Jilin, Shandong, and Zhejiang, as it enforces pollution regulations.

For multinational companies that have subsequently had their supply chains interrupted, this has been disastrous – particularly in the peak autumn season before Christmas. Given that China's environmental objectives were amended in the Environmental Protection Law in January 2015, Chinese authorities have been unsympathetic to their plight.

"This environmental crackdown must be understood as part of the new normal," says Neal Beatty, Partner and General Manager of global risk consultancy, Control Risks. "And just as the anti-corruption campaign significantly affected how multinationals operate compliantly in the market, environmental enforcement is set to shake up supply chain management, compliance and reporting as the next big operational hurdle."

For international companies, it can be impossible to predict whether or not their suppliers will be affected. *The Journal of Commerce* noted that the MEP isn't just targeting tier-1 suppliers: it is pursuing component suppliers as well. Many importers, especially smaller businesses, are unaware of who supplies their suppliers, or whether that component supplier has been following China's strict environmental regulations.

The new green state

The net for suppliers and manufacturers is about to get tighter. In December 2016, China announced its first Environmental Protection Tax Law in order to strengthen the enforcement of environmental regulations. This law imposes taxes on entities that emit solid waste, air and water pollutants, and noise pollution, and will come to effect on 1 January 2018.

All of this heralds greater scrutiny of corporate environmental performance.

The new law will replace China's Pollution Discharge Fee, which has been in place since 1979. Among other objectives, the law aims to address the issues of ineffective enforcement in levying pollution discharge fees and to increase enterprises' responsibility in pollution reduction, reports *Global Legal Monitor*.

“**China's senior leadership is merging environmental goals with wider industry goals, particularly with regards to cutting overcapacity and upgrading industries. Smaller, inefficient operators will not be allowed to reopen. The government views this as an essential part of upgrading China's economy.**

– Neal Beatty and Julia Coym, Control Risk

”

"China's senior leadership is merging environmental goals with wider industry goals, particularly with regards to cutting overcapacity and upgrading industries. Smaller, inefficient operators will not be allowed to reopen. The government views this as an essential part of upgrading China's economy. This can also be seen in the intensifying relocations for manufacturing companies in recent years," said Julia Coym, Senior Analyst at Control Risks.

Authorities' responsibilities are shifting, said Coym. "Environmental authorities are being freed from potential conflicts of interest, by introducing vertical reporting structures (where each environmental agency reports to a more senior environmental agency, rather than their local government heads). Local mayors in those jurisdictions, and the rest of the country, have seen their influence on environmental issues erode. They can no longer overrule environmental restrictions or penalties" she explained.

In other words, China's seriousness in managing its environment is likely to result in additional production disruptions and the closure or production suspension of factories throughout the country in a wide range of sectors.

How to protect the supply chain?

Finding environmentally compliant sources is no longer a "nice to have" option for businesses; going forward, it could spell the difference between corporate sustainability and closure. Subsequently, businesses can no longer approach costs as though product manufacture were a "cash on the barrelhead" proposition.



Clearly, factories have been able to charge low prices in part because they didn't comply with environmental regulations. Some may have fallen under the umbrella of a local rule that allowed them to keep manufacturing; others may have local regulatory connections that looked the other way. Today, those factories are time bombs and their customers will be collateral – if not wholly innocent – damages.

Get ahead of the problem

Companies need to study, understand and engage with their suppliers, as well as stay abreast of policies and sector specific trends, says Coym. Asking suppliers about their inspection history: their last inspection or audit is a simple first step. Discovering what certifications or licences suppliers hold (and seeing copies), conducting a site visit where possible, and looking for hazards in person is useful.

"Inspections serve as a good reminder that companies need to know their entire supply chain, and ensure they are environmentally compliant. This is about conducting thorough due diligence on business partners and identifying any compliance red flags that indicate there are current or likely future environmental or business issues", explains Beatty.

Companies need to understand the drivers and the timing of wider enforcement in order to stay ahead of local government and sector-specific trends as well as one-off investigation and shutdown triggers such as industrial accidents or seasonal pollution, said Beatty.

Ultimately, foreign companies must focus on due diligence at a company-to-company level if they are going to weather China's onslaught of factory shutdowns, and to do that, they will need to engage.

"Companies will have to renew and intensify their communication on environmental issues with all regulators. Going forward, companies' narratives around their environmental performance and their environmental contribution will become much more essential, not just when dealing with environmental inspections, but for all regulatory approvals" explained Coym.

It's never too late

For companies with suppliers in the Pearl River Delta, or anywhere in Guangzhou, it is well past the time for a serious risk assessment. If there are concerns about investigations or possible shutdowns, it may be time to look for alternatives before supply chain losses are real. Shifting cargo from sea to air to meet deadlines will only drive up demand for airfreight services and prices, which – around the holidays – are already astronomical.

It's not easy being green, but it is worth remembering, that for this short-term pain there is a promise long-term gain. China's move can only improve air, water and soil quality. Ultimately, this means there will be a future that makes business worth sustaining. **B**

We collect and deliver your car FREE OF CHARGE

(subject to distance)

We provide good, quick repair service at reasonable prices

Our competitive Labour charges:	From
Lubrication Service	\$ 210
Tune Up Engine	\$ 800
Engine Decoke & Grind Valves	\$ 2,500
Engine Overhaul	\$ 5,500
Brake System Overhaul	\$ 1,200
Clutch Mechanical Overhaul	\$ 1,700
Air Condition Freon Recharge	\$ 400
Alternator Overhaul	\$ 700
Starter Motor Overhaul	\$ 700

ALL REPAIRS WITH THREE MONTHS GUARANTEE

Our Business Hours

8am-6pm, Mon-Sat & Public Holiday

Our 24hrs. Emergency Towing Agent

"We Tow Towing" Tel :6128-0999

Please call us at 2565 6166 or Fax: 2856 1047

E-mail Address: fookie@netvigator.com



FOOKIE MOTORS CO. LTD.

Shop 7, G/F, Paramount Bldg.,
12 Ka Yip Street,
Chai Wan, Hong Kong.