

SPECIAL REPORT

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IRREGULARITIES COMPOUND CHINA PPE SOURCING PROBLEMS

The Wall Street Journal reports that China's supply chain for medical goods is devolving into a free-for-all as foreign governments, hospitals and businesses, and all their middlemen, descend on the country to secure ventilators and masks and other personal protective equipment (PPE). Inundated with prospective buyers, Chinese factories are taking advantage of their plum position, dictating buying conditions and demanding advance payments in full, while buyers must quickly vet newly-minted vendors, sometimes by video from the other side of the world.



The disarray in China, a major producer of PPE, underscores how desperate U.S. and other buyers have become to secure medical gear as the pandemic engulfs them. Left with few alternatives, buyers now pay for almost everything upfront, with Chinese manufacturers demanding as much as 50% upon signing the contract and the other 50% before the goods are handed over.

Typically, institutional buyers conduct extensive vetting and pay suppliers about a month after receiving the goods. But in the current health crisis, many are having to balance their traditional standards with the need to act quickly. State governments, used to a bidding process that can take months, have been especially hamstrung by the race to navigate China's opaque, complex and fast-changing supply chain network.

Extreme demand has outstripped PPE supply, creating an acute market imbalance. This condition is ripe for fraud and unscrupulous sellers, so 'buyer beware' precautions are an absolute necessity.

"You are often dealing with middlemen or a shell [company] within a shell within a shell," said Illinois Deputy Governor Christian Mitchell, who has approved the purchase of more than 10 million pieces of PPE from China. "You have to accept a level of risk that you normally would not do on the taxpayer dollar." To grab hold of critical face masks, the U.S. federal

government has already committed itself to \$110 million in orders at high prices and with unproven vendors, The Wall Street Journal reported.

One adviser to U.S. state governments trying to procure PPE from China was sent an official-looking certification purporting to be from the U.S. Food and Drug Administration, with the words "Insert Number here" on the document, by a prospective supplier. Turns out the certification was fabricated and the supplier had forgotten to replace the words with numbers, said John Evans, the Bangkok-based managing director of management consulting company Tractus Asia Ltd.

In another case, Mr. Evans recounts, Chinese suppliers turned over addresses of warehouses that the suppliers said were filled with masks available for sale. Upon further inspection, the facilities turned out to be empty. A Chinese government spokesman said this week that the country provides urgently-needed medical supplies to more than 150 countries and international organizations. Earlier this month, China introduced tighter customs regulations after complaints about low-quality Chinese PPE exports.

Black market activity has emerged and even prior orders from reliable suppliers are subject to interruptions, delays and changing terms.

Further complicating the process is a sprawling and unruly black market. Sales staff at a Shanghai area factory operated by Dasheng Health

Products Manufacturing, described by one middleman as the “Louis Vuitton” of masks for the company’s high product-quality standards, told prospective customers earlier this month that it couldn’t supply masks until October. Even so, a Wall Street Journal visit to the facility one recent April afternoon found a nearby tree-lined side street bustling with dozens of men doing a brisk trade in masks that they said were from Dasheng’s production lines. Two men claimed to have an allocation of five million masks secured through a contact inside the plant, which they offered to resell at 18.50 yuan (\$2.62) per mask. Their cut: two yuan per mask.

Landing the products doesn’t guarantee that they will make it across the Pacific. Regulatory hurdles in both countries have made the products’ export a minefield.

A reduction in airfreight volume has produced even more headaches. China began limiting foreign airlines to one inbound flight a week last month, significantly reducing the amount of cargo that can be flown out of China in passenger planes.

Once obtained, getting the goods freighted is another tripwire, with customs regulations stricter and air freight volumes severely curtailed.

United Parcel Service Inc. has begun to limit customers’ shipment capacity from China to 50 kilograms a day from 1,000 kilograms a day last month, said Duncan Abdelnour, founder of CrowdHealth Source LLC, which buys the Chinese equivalent of the N95 masks for U.S. customers.

The tighter rules means he can only ship some 3,000 masks each day, he said, adding that anything more is charged at much higher rates.

Bulk freight prices have also risen dramatically. According to global logistics firm ClearFreight, airfreight rate to the U.S. from China have increased to at least \$17 per kilogram this week from roughly \$3 in January.

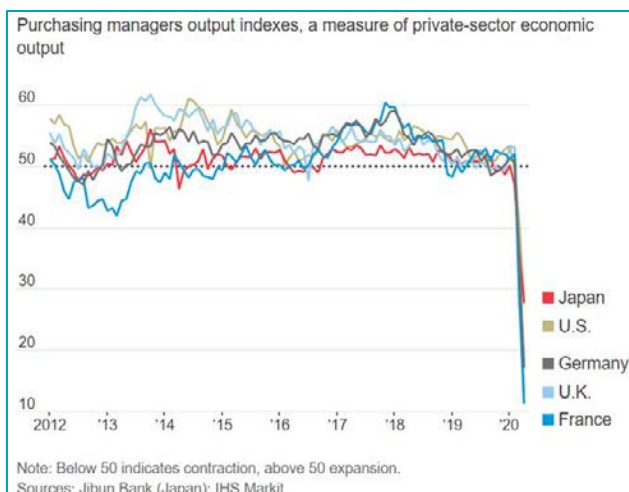
Charter flights are possible, but pricey, sometimes costing more than \$1.5 million, or more than double the usual price, said Khim Lim, ClearFreight’s vice president of sales and marketing. Still, it is something ClearFreight is considering, she said, pointing to skyrocketing spot market rates for both passenger and cargo flights.

PURCHASING SURVEY SHOWS SEVERITY

Business activity in the U.S., Europe and Japan collapsed in April as governments tightened restrictions aimed at limiting the spread of the coronavirus. Across the board, IHS Markit's surveys of purchasing managers fell to record lows, underscoring the severity of a global economic contraction.

A NOTE FROM PROCUREABILITY

In the last few weeks, the coronavirus has drawn the world's attention. First and foremost, we hope that you, your family, your friends and your colleagues are keeping well in these uncertain times. COVID-19 has disrupted the economy, normal work patterns, and just about every aspect of life. Our priority from day one has been to focus on all our people, both internal employees and external client teams. We want to simply recognize that we understand the pressures you and your company are under. Price volatility and supply chain uncertainty, combined with challenging economic conditions, make each day's decisions that much more consequential. If you're like most of the customers we've worked alongside, you've built a culture of preparedness from decades of experience. However, COVID-19 has been very effective in showing how unforeseen circumstance can trigger a cascade of devastating problems. As always, all of us at ProcureAbility stand with you. We're ready. Please give us a call or drop us an email if we can help you.



References: Lin, Liza and Xiao, Eva. "China Medical Goods Market" WSJ, April 24, 2020. HIS Markit. Survey of Purchasing Managers. April 2020.

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