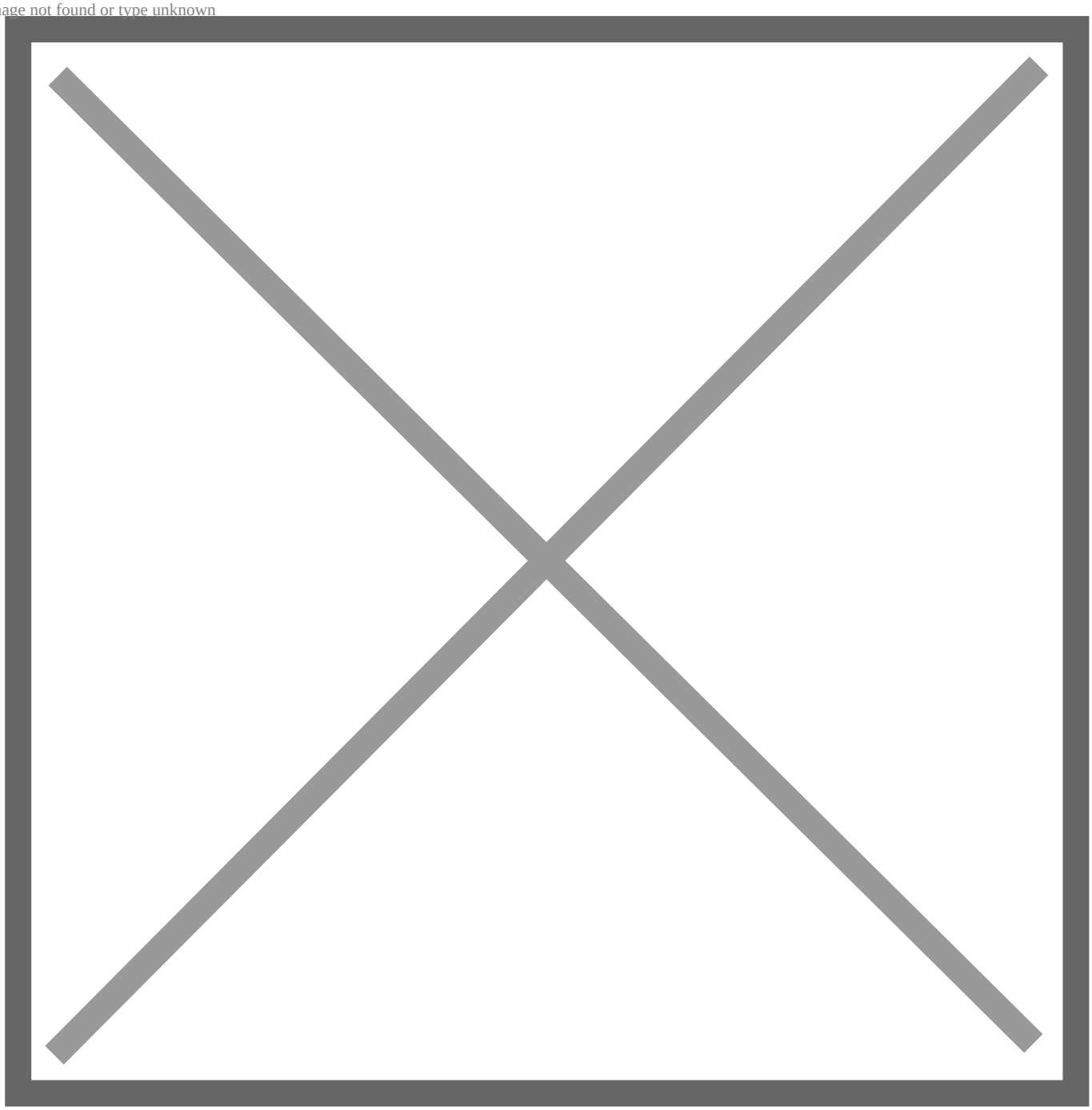
With Lockdowns in China, Can Your Supply Chain Remain Resilient Against Crises?

TAGS Supply Chain Logistics

ARTICLES | 25 April 2022

Image not found or type unknown



For small businesses in Europe and China, recent COVID lockdowns in China's major cities and the Russian invasion of Ukraine cause unprecedented disruptions to their supply chains. How can a European small business survive in this time of crisis, what lessons can be learned to build a more resilient supply chain strategy for the future?

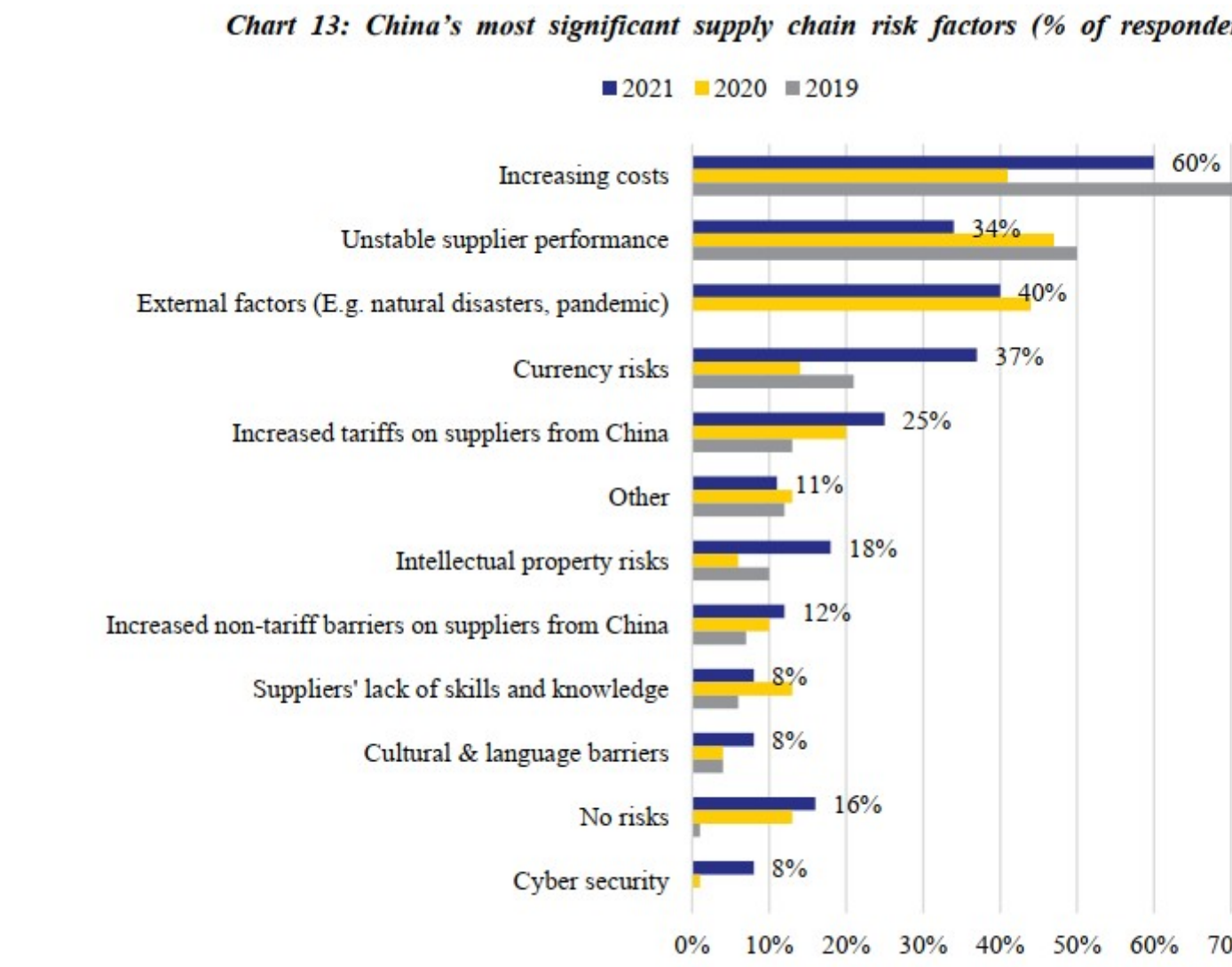
In this article, the EU SME Centre provides a policy update from the EU in this effort, shares recent survey results that reflect European businesses' sentiments towards the Chinese market during the Pandemic, and offers practical advice for small businesses on how to strengthen their supply chain fundamentally in long term.

At the beginning of 2021, many thought that the most difficult challenges brought by the COVID-19 pandemic were over, not expecting the global supply chain to receive further pressure from disruptive events worldwide – such as a surge in consumer demand for logistics, container shortages, and semiconductor and raw materials shortages.

Even fewer people expected the situation to further exacerbate at the beginning of 2022, with the Russian invasion of Ukraine as well as the full or partial lockdowns in multiple cities across China – most significantly Shanghai – disrupting manufacturing and shipping activities. Indeed, the past months turned out to be more challenging than ever for European companies with supply chains in China.

The resilience of the Single Market and supply chains has become a cornerstone of the EU's Industrial Strategy. The EU is now applying a policy mix addressing strategic dependencies, ensuring a level playing field, supporting the multilateral rules-based trade environment, incentivising investment also through research & innovation, and establishing new international partnerships and alliances – SMEs are expected to play a key role in this process. This issue has also gained particular momentum in China with the release in April 2022 of a set of **Opinions to Establish a Unified Domestic Market**, intending to address the fragmentation of production and utilisation of resources, particularly by improving interconnectivity of energy supply chains, infrastructure and trading platforms.

In a survey conducted by the authors of the EU SME Centre report Supply Chain in China: Challenges and Good Practices for SMEs within Industrial Goods, factors such as "increasing costs", "unstable supplier performance", "external factors", as well as "currency risks" were of highest concern to companies already having sourcing activities in China.



European businesses in China

Despite growing disruptions in the supply chain and the geopolitical context, and although some alternative sourcing markets are becoming more mature and popular amongst international companies, **there continues to be a certain interest for European industrial companies to produce in or source within China**. They do so for both global markets as well as for the specific Chinese market, where local consumers and industrial companies are increasingly upgrading their requirements on quality and sustainability.

The European Chamber's European Business in China – Business Confidence Survey 2021 reported that only **9% of the surveyed companies were considering moving current or planned investment out of China**, the lowest level on record. Instead, surveyed companies were considering strengthening their investments, increasing their shares in existing joint-ventures, and onshoring their supply chains in the country. Similarly, a survey published by the German Chamber of Commerce in China in March 2022 shows that only **10% of German companies surveyed have the intention to move out their business from China**, and that around one-fourth of companies are accelerating the onshoring in China of parts of the supply chain or business functions.

It can be argued that the above trend is mainly a response to market factors, such as securing operations, consolidating market share, and being closer to suppliers of key components, clients, and innovation forces. Political factors also play a role, such as pre-condition to operate in certain sectors in China or risk mitigation amidst an increasingly uncertain geopolitical context – and it can be expected that these will become even more prominent also in view of China's unwavering adherence to its zero-tolerance policy to COVID-19.

Although it's too early to assess the long-term impact on supply chains, both the invasion of Ukraine and lockdowns have already negatively affected the business sentiment of European companies operating in/with China. Indeed, around half of the German companies surveyed by the German Chamber of Commerce in China report complete or severe impact from China's pandemic prevention measures as well as the current geopolitical crisis. This results in an overall decrease of the attractiveness of the Chinese market compared to others.

Good practices for European companies with supply chain in China

Currently, there are no positive indications on when the pandemic and the geopolitical situation will subside. Against this backdrop, the recent EU SME Centre report Supply Chain in China: Challenges and Good Practices for SMEs within Industrial Goods, provides a set of good practices for European companies with supply chains in China, covering:

- **Evaluation of supply chain strategies**, both at the strategic level (e.g. analysis of new trade and investment agreements such as RCEP, trade tensions, prices, carbon emissions, industrial policies, etc.) and operational level, aimed at identifying areas of improvement based on data and transparency of supply chain.
- **Risk analysis and mitigation**, enhancing communication with suppliers, reviewing contracts in place, assessing the feasibility to diversify the suppliers base, planning in scenarios, developing contingency plans for specific suppliers and regions, and reassessing one's own bargaining power.
- **Monitoring and post-production feedback systems**, enabling better traceability of production activities and progress, contributing to the planning of future activities, and providing input on how to improve the overall supply chain.

China's supply chain landscape has profoundly changed the way in which companies view risks in their supply chains; but the good practices for having a structured and data-driven approach to enable efficient supply chains have not been fundamentally affected. Companies should be ready to work with a range of scenarios for strategic planning and make continuous efforts to strengthen processes and supplier relationships.

Looking ahead: EU Directive on sustainable corporate governance

The issue of sustainability and due diligence throughout global supply chains will become much more prominent for European companies operating in/with China. In February 2022, the European Commission published a proposal for a Directive on Corporate Sustainability Due Diligence, aiming at fostering sustainable and responsible corporate behaviour throughout global value chains.

The proposal outlines a series of actions that all EU companies and non-EU companies active in the EU will need to adopt to **identify, prevent, end or mitigate adverse impacts of their activities on human rights**, such as child labour and exploitation of workers, and on the environment, for example, pollution and biodiversity loss.

Although SMEs are not directly in the scope of the proposal, they will be exposed to some of the costs and burdens through business relationships with companies in scope as large companies are expected to pass on demands to their suppliers. Larger companies partnering with SMEs will also be required to provide support in fulfilling the due diligence requirements, in case such requirements would jeopardise the viability of the SME.

The proposal is not yet into force – it needs to be approved by the European Parliament and the Council, and then transposed into national law by all the EU Member States – but this appears as an inevitable direction to which EU SMEs should already start preparing. It is also noteworthy that some EU Member States, including Germany and France, have already adopted national-level laws outlining corporate due diligence obligations in supply chains; and although these laws tend to target larger companies, European SMEs doing businesses with German and French suppliers would be well-advised to ensure they have a solid understanding of these laws, as they might impact them indirectly.

Recommended Reading

Supply Chain in China: Challenges and Good Practices for SMEs within Industrial Goods

This report gives an overview of the Chinese supply chain environment relevant for European industrial SMEs. Specifically, it details recent regulatory changes and shows the regional differences among key geographical manufacturing clusters in China. In order to increase the understanding and capability to tackle the challenges originating from logistics and component shortage, the report also provides examples of basic frameworks that companies can use in making strategic choices, giving practical advice on some common pitfalls. This success depends on applying global good practices, an awareness across the company organisation about the Chinese context, as well as implementing ways of working that are adapted to the company and its objectives with sourcing in China.

The report also provides a series of practical tips to guide EU SMEs to conduct due diligence on Chinese partners, together with an overview of the European Commission's proposal for a Directive on corporate sustainability due diligence, released in February 2022.