Apple and Foxconn: It's complicated

For the sake of argument, let's say Apple, after suffering criticism for the actions of one of its business partners, threw down the gauntlet and told Foxconn Electronics to change its labor practices.

Let's say Foxconn countered with, "Or what?"

If you think the immediate consequence would be Apple's taking its business elsewhere, think again. Untangling itself from Foxconn—or any other EMS company—would be tough for even Apple.

In general, EMS-OEM relationships are complicated. A company such as Apple bids out its business to any number of EMS providers. Not only does an OEM want the best possible price, but it's also sharing details of its product design, business strategy, bill of materials (BOM), end-customer forecasts and even technology road map. Those decisions are not made lightly.

When you're as enmeshed as these two are, breaking up is hard to do

The EMS company bidding on such business has to look at a number of things internally. First, does it have the technical capability to make Apple's products? Does it have ample capacity? Does it have relationships with the correct suppliers?

If it has a direct relationship with a supplier, it might receive a volume discount. But if Apple manages the supplier relationships, it may have a better discount.

If Apple does manage the relationships, it might not want to share the price it gets with its EMS partner, so the partner's cost estimate would come down to guesswork.

Assuming those hurdles are cleared, the next one is confidentiality. EMS companies are not dedicated to one OEM; to hedge their bets, they manufacture for many OEMs. How separate would Apple's lines be from, say, Dell's? Would workers overlap? How would designs, the BOM and other deliverables be transmitted and handled? Which suppliers, if any, do Apple and Dell have in common, and is the EMS provider leveraging the combined volume? If so, are the savings being passed on to one or both OEMs? How would the OEM even tell?

Next is the question of scale. If Apple had a massive ramp in demand, would the EMS be willing to move manufacturing capacity from another OEM to accommodate Apple? Would workers be willing and able to shift? Who would approve the overtime? If Apple had a sudden drop-off in demand, would the EMS lay people off? Would there be labor contracts to honor? Would the EMS pass on those costs to the OEM?

Once the OEM and EMS have established a partnership, issues such as customization may come along. Maybe a new manufacturing process is unveiled, and Apple wants the EMS to use it. The EMS has to create a manufacturing line (or lines) to accommodate that.

But there is always a risk involved. What if Apple changed its mind? Would the EMS stick Apple with the cost of adding the lines? Would it use the new process for other customers? Could the EMS even do that, if the process had been developed for Apple?

The issues mentioned here just skim the surface of the typical OEM-EMS relationship. Apple's deals with Foxconn are no doubt hundreds of times more complex.

So where would Apple go if Foxconn refused to budge? Sure, there are other EMS companies, but picking up a customer like Apple takes time.

Charlie Barnhart, principal of the EMS consulting firm Charlie Barnhart & Associates, told *EBN* in an e-mail that it takes just more than five quarters—from the first internal talks to the first delivery of product—for the typical OEM to implement a new EMS relationship. "Obviously," he adds, "there is a big range around this average, depending on the scale, approach and complexity of the project and the experiential level of the OEM."

Foxconn, of course, is the EMS industry's 800-pound gorilla. It's so big that analysts like Barnhart have created a new category, the Goliath Fringe, just to describe it. Foxconn is one of the few companies in the world that might be able to stare down Apple.

If Foxconn saw the light and began to change, you can be sure that the prices of products—not just Apple's—would rise. If Foxconn called Apple's bluff and sent it elsewhere, not only would there be a shortage of Apple products, but its already-premium prices would go through the roof.

The idea that outsourcing gives OEMs more flexibility is true only to a certain extent. When you are as enmeshed as Apple is with Foxconn, a breakup wouldn't just hurt the companies. It would hurt everyone. ■

By Barbara Jorgensen (*barbara.jorgensen@ubm.com*), community editor at *EE Times* sister publication *EBN*.