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APPLE AND ITS SUPPLIERS: CORPORATE SOCIAL RESPONSIBILITY

Sun Hye Lee, Michael J. Mol, and Kamel Mellahi wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

Will it ever be good enough? That was the key question facing Apple Inc., (Apple) the California-based multinational technology company that was known for its innovative hardware, software, and online services. Apple had been accused of having allowed labour rights violations in China at Foxconn, a major supplier of its products in 2009, but the company had worked hard to overcome these issues to avoid any negative ramifications for its corporate image. Yet on December 18, 2014, new evidence was presented in a British Broadcasting Corporation (BBC) documentary that showed that labour rights violations continued to occur in China, this time at Pegatron, another large Apple supplier that specialized in the assembly of Apple's iPhones [1] This documentary questioned Apple's repeated statement in its 2014 supplier responsibility progress report that "Each of those workers has the right to safe and ethical working conditions."[2]

Jeff Williams had been promoted to the role of senior vice president for Operations only 15 days earlier, when he was put in charge of what Apple called "end-to-end supply chain management . . . dedicated to ensuring that Apple products meet the highest standards of quality."[3] Given the huge progress that Apple had achieved, was the company simply being singled out unfairly because of its size, visibility, and earlier problems? Indeed, Apple now had an excellent reputation in terms of corporate social responsibility (CSR) and, in 2014, had been ranked fifth on *Forbes*' "best CSR reputations" list.[4] As Apple's stock market value moved ever closer to US$1 trillion,[5] did outside observers hold Apple, the most valuable company ever, to a higher level of corporate social responsibility? Alternatively, had the company still not fully come to terms with the nature and magnitude of its CSR challenges?

It had indeed proven to be difficult to maintain control over Apple's vast operations, particularly when most activities were undertaken through outsourcing to independent suppliers that were mostly situated in offshore locations, such as China, far from Apple's base in California. Perhaps the most important question of all was what Williams and Apple could do to tackle the allegations. Would it suffice to adopt a defensive strategy, by simply denying that the problem was structural in nature and pointing to Apple's many and costly efforts? Or should Apple's management instead engage with the issue and instigate further CSR changes in its sourcing strategy? If so, what changes should be implemented? In short, how should Apple and Williams respond?

THE SMARTPHONE INDUSTRY

In 2014, more than 1.2 billion smartphone devices were sold worldwide, for combined revenues of more than $380 billion.[6] The competition among the major players — Samsung, Huawei, HTC, Nokia, and Apple — had started to take a toll on the industry's profitability, which led industry experts to suggest that the smartphone industry was reaching its maturity stage, with year-on-year growth set to gradually decline. Apple was the largest player in the industry, accounting for more than 90 per cent of profits in the fourth quarter of 2014 and the first quarter of 2015.[7] Samsung dominated the low end of the smartphone market, while Apple dominated the more lucrative high end. The low-cost players, Lenovo and Xiaomi, which were introduced to the smartphone market in 2012[8] and in 2011[9] respectively, broadened the reach of the smartphone market to lower-income countries and intensified competition among the key players in the market.[10] The smartphone market had reached a saturation point in western markets, but was still expanding in emerging and low-income countries, providing new emerging-market multinationals such as Xiaomi with a potential competitive edge over traditional players such as Samsung, Apple, and LG.[11]

Besides its superior aesthetic design and cutting-edge features, Apple's products were differentiated from those of its competitors by its use of a proprietary operating system (iOS) and its connection to Apple's successful iTunes website that offered multimedia content for the iPhone and other Apple products. Because of its differentiated position, Apple's iPhone commanded a premium price, which drove up Apple's profitability and market value.[12]

APPLE, THE IPHONE, AND CUSTOMER LOYALTY

Apple was not only the world's most valuable company but also a hallmark of how information technology could change lives. The company was founded in 1976 and started to encroach into the personal computer market from the late 1980s and early 1990s onward. After the company nearly experienced a total collapse, it convinced co-founder Steve Jobs to return in 1997 to revive the company. Jobs and his team succeeded with great verve, launching such innovative products as the iPod and the iPad.[13]

However, Apple's greatest success (as of the writing of this case) came from its debut in the smartphone market.[14] Ever since the introduction of the first-generation iPhone in 2007, Apple was recognized as the market leader of the smartphone industry with its cutting-edge technology and design, enabling it to charge a premium price and obtain a very high profit margin. In 2013, Apple's sales revenue reached $170 billion and its net income was more than $37 billion. In 2014, Apple's revenue rose to nearly $183 billion, with net income reaching $39.51 billion. Apple experienced exponential growth since 2008 (see Exhibit 1), and the iPhone was the biggest contributor to its success (see Exhibit 2)

Apple customers were extremely loyal to Apple products, often also buying its computers and tablets alongside the iPhone. For example, a survey conducted by Simonlycontracts.co.uk found that nearly 60 per cent of 3,000 iPhone owners declared that they had "blind loyalty" to their iPhones, and 78 per cent said they couldn't "imagine having a different type of phone."[15]

The Foxconn Affair

Foxconn, headquartered in Taiwan, was one of Apple's biggest and oldest suppliers. In 2014, Apple contributed more than 40 per cent of Foxconn's revenue. It was the biggest privately owned company in Taiwan with $131.8 billion sales revenue in 2013, and operations that stretched around the globe. Despite its large size, Foxconn, as an original design manufacturer (ODM) had long been an unfamiliar name in the public eye, chiefly because it did not produce its own branded goods.

In 2009, however, the Foxconn name suddenly came to prominence when a factory worker reportedly committed suicide after losing a prototype of the iPhone 4. It was later alleged that the employee's treatment during questioning came close to being torture. One year later, another 18 Foxconn workers attempted to kill themselves, and 14 died at the manufacturing company's facilities.[16] Various explanations were offered for these deaths. Poor labour practices and working conditions were considered to be the main motivations for the employee attempting to commit suicide. Ever since the 2010 incidents, the company had been under increased scrutiny and pressure to improve its working conditions from various stakeholders, including non-governmental organizations (NGOs), the media, and customers such as Apple.

The Pegatron Crisis

After the Foxconn scandal, Apple and its suppliers were under more scrutiny than ever before. Apple made various promises to improve its practices. One of Apple's responses was to move some of its business away from Foxconn to Pegatron, a Taiwanese electronics manufacturing company that mainly assembled the iPhone 4, 4s, 5, and 5c, along with Apple's iPad. The company's factories were located in Taiwan, mainland China, the Czech Republic, and Mexico, while its customer service centres operated in the United States and Japan. Since it started producing Apple products in 2011, Pegatron showed remarkable increases in revenue that mirrored those of Apple itself, from TW$599.9 billion in 2011[17] to TW$881.2 billion in 2012[18] to TW$949.8 billion in 2013.[19]

In 2013, China Labor Watch (CLW), a U.S.-based NGO, whose mission was to increase the transparency of factory labour conditions in China, published *Apple's Unkept Promises*, a report based on an undercover investigation into working conditions at Pegatron factories. The situation was even more serious than at Foxconn. According to the report, three Pegatron factories in China had violated 86 Chinese regulations, including 36 legal and 50 ethical violations, ranging from use of a juvenile workforce, to violations of women's rights, excessive working hours, and environmental pollution.[20] In response to the public disclosure of the report, Apple again promised its full dedication to addressing those issues.[21] Jason Cheng, Pegatron's chief executive officer (CEO), also stated, "We will investigate the allegations fully and take immediate actions to correct any violations to Chinese labour laws and our own code of conduct."[22]

Nonetheless, on December 19, 2014, the global news media again accused Apple and Pegatron, alleging that Apple had "broken its promises." The previous day, the influential BBC *Panorama* program had broadcast a documentary based on an undercover investigation of the actual practices and working conditions at a Shanghai factory owned by Pegatron. The factory specialized in producing Apple products, including the iPhone. A variety of poor practices were exposed. For example, workers had to hand in their identification cards before entering the factory, were given no basic health and safety training, and had to work excessive hours — up to 16 hours a day, which would sometimes continue for 18 consecutive days. According to the documentary, workers' requests for a day off were routinely ignored. Another scene in the documentary showed workers who could not help but fall asleep in the middle of a busy production line. The quality of life outside the factory was also criticized. Dormitories were overcrowded, and consisted of nothing but 12 tiny beds placed end to end.[23]

Apple did not comment on camera for the BBC documentary, but the next day, Jeff Williams clearly expressed what he and Apple CEO, Tim Cook, felt about the documentary. Their "deeply offended" feelings were delivered to the 5,000 U.K. Apple employees in the form of a letter, which became public when it was published by the *Daily Telegraph*.[24] In the letter, Williams said, "We know of no other company doing as much as Apple does to ensure fair and safe working conditions, to discover and investigate problems, to fix and follow through when issues arise, and to provide transparency into the operations of our suppliers."

CSR CHALLENGES

In its 2014 progress report, Apple confidently remarked, "At Apple, we believe in making complex things simple."[25] This statement was an apt description of its products' appeal to consumers and in the area of product design. Apple retained firm control to ensure it could deliver on this promise, but when it came to supply chain management, an approach of simplification could have its limitations. Given the global nature of Apple's supply chain, the various products it produced, and the technological complexity of these products, Apple needed to work with a wide array of suppliers. To fulfill its "promise," Apple needed to be aware of and appropriately manage all these relationships. Doing so raised various challenges.

Some of these challenges related to the various formal and informal national institutional regimes that applied to various offshore locations. Apple and its suppliers operated in very different cultural, legal, political, social, and economic environments. For example, its two key suppliers, Foxconn and Pegatron, conducted their manufacturing operations mostly in mainland China. The top 200 suppliers on Apple's supplier list were scattered around the world, ranging from Korea, Japan, and Taiwan, through to Ireland and the Czech Republic.[26] As much as Apple may have wanted to make complex things simple, it could not single-handedly change these diverse national environments to suit its own purposes. Apple and its suppliers faced completely different stakeholders with different expectations. Apple needed to deal with high expectations from consumers, employees, investors, NGOs, and governments in the United States and other developed countries, while most of the suppliers were located in emerging countries that had much lower expectations and different social values and norms. *Forbes*, for instance, commented on the *Panorama* documentary:

> While these issues are faced by every manufacturer, only Apple was specifically named in the programme. More than any other company, Apple has been the leading target for campaigners on working conditions, but it seems unfair to single out one manufacturer for the alleged sins of an industry.[27]
>
> No solitary manufacturer can walk into the supply chain and demand working conditions far in advance of the prevalent conditions of the country. Change will be gradual, and measured over years, if not decades.[28]

A second set of challenges related to maintaining close buyer-supplier relationships. Apple was notorious for its price policy, squeezing suppliers to produce products at lower and lower costs.[29] An executive from one of Apple's iPad producers stated that "the only way you make money working for Apple is figuring out how to do things more efficiently or cheaper . . . and then they'll come back the next year, and force a 10 per cent price cut."[30] Companies such as Foxconn dealt with conflicting demands: meeting higher working standards, which included paying higher wages, reducing working hours, investing in safety programs, and providing training, while also accepting lower and lower prices from Apple.

Foxconn appeared to have made an effort to improve working conditions and meet the required labour standards. This effort was recognized by the Fair Labour Organization, which announced improvements in labour practices in Foxconn factories. Ironically, however, Foxconn started losing orders from Apple around the same time that it had improved its labour practices, perhaps due to the increased per unit costs.[31] Apple began to give more and more volume to rival supplier Pegatron. Apple argued that Tim Cook, himself a supply chain management expert, realized the need for supply chain diversity to reduce the dependence on a single supplier and to spread risks.[32] Furthermore, some had hinted that the close relationship between Apple and Foxconn was partly built on the personal relationship between Steve Jobs and the president of Foxconn; when Jobs passed away, so did some of the inter-organizational relationship.[33]

However, the reason for the switch from Foxconn to Pegatron might have been less straightforward. It was suggested that Pegatron was willing to accept thinner margins than Foxconn,[34] which in turn allowed Apple to produce a cheaper version of the iPhone 5 series, the iPhone 5c, while not undermining its profitability. According to the *Wall Street Journal*, Pegatron accepted a margin of 0.8 per cent, while Foxconn had been seeking 1.7 per cent.[35] Interestingly Apple's own gross margin was 38.6 per cent as of 2014 and 37.6 per cent in 2013.[36] Some observers argued that with such small margins it was little wonder that suppliers breached costly regulations in the area of labour rights.[37]

A third set of challenges arose from differences in the companies' objectives, particularly their objectives in terms of CSR. However, because of Apple's huge size, stock market value, visibility, and (partly self-created) image, it faced more scrutiny than perhaps any company in the world. Writing in *alphr*, Barry Collins argued:

> Apple doesn't outright deny any of those allegations. Yet, it does pose the question: why pick on us? . . . It's not the only tech company using cheap labour in Asian factories: in fact, show me one that isn't. Panorama could equally have substituted Apple for Microsoft, Samsung, Sony, or even a British firm such as Tesco, which has its Hudl[38] tablets made in the same factories as Apple does. Picking on Apple because it's the only company that's made a public commitment to improving worker welfare seems a little perverse.[39]

Simon Rockman of *The Register* commented, "while Apple may well be right . . . the difference lies in the gap between what the richest company in the world has said it would do, and what it has achieved in reaching the standards it set for itself."[40] According to Brad Reed:

> The point of all this isn't to say that Apple is an "evil" company or that anyone should feel guilty buying an iPhone or a Mac. I'm also not calling on Apple to pull manufacturing operations out of China since I know how important these jobs are to people who work at them.
>
> However, there's nothing wrong with insisting that our favourite companies — whether we're talking Apple, Samsung or Google — do better on issues of worker treatment, especially when they've repeatedly vowed to do so. Apple makes insane profit margins on its iPhones and it can certainly afford to commit more resources for ensuring that the people who manufacture them aren't forced to work 18 days in a row.[41]

Reed's comments in fact seemed to resonate with the company itself because even Williams mentioned in his letter that Apple "can still do better."[42]

Finally, it was important to acknowledge that individuals differed in their assessment of how much attention should be paid to these labour rights issues and what constituted an acceptable level of working conditions. According to a *New York Times* article, Richard Locke, a professor at Brown University, "had studied working conditions for many companies, and Apple has gone beyond standard practices."[43] But at the same time, Li Qiang, the executive director of CLW, said, "Apple is always finding excuses for its unrealized commitments. We are focused on what Apple does, not what it says."[44] Such differences in perception were almost impossible to avoid in cases like this, but they did pose a fourth set of challenges faced by Apple: Did it want to satisfy its harshest critics, or was it enough to please a mainstream Apple consumer?

APPLE AND OFFSHORE OUTSOURCING

"Designed by Apple in California" and "Assembled in China," read a statement imprinted on the back of Apple's iPhones and iPads and on the bottom of its Mac products, neatly capturing Apple's strategy of offshore outsourcing. As of 2004, with the closure of its very last U.S. manufacturing line, Apple was outsourcing all of its production and assembly lines to global suppliers, mainly in China.[45] Prior to that, Apple was rather proud of its products being produced in America. But like other western companies, Apple found it difficult to resist the lure of offshore outsourcing.

It was estimated that around 90 per cent of the iPhone's parts were manufactured overseas. German and Taiwanese contractors provided advanced semiconductors, while Korean suppliers provided memory and display panels. Those components, coupled with chipsets supplied from Europe and elsewhere, were ultimately assembled in China.[46] Apple's sophisticated supply chain offered the needed flexibility to meet fluctuating demand. Just before the debut of the first iPhone in 2007, Steve Jobs realized that the screen material needed be changed from plastic to glass so it would not get scratched. He was quoted as saying, "I want a glass screen. . . . I want it perfect in six weeks."[47]

While no American company could produce the glass screens in a month, a Chinese company was able to make them. To meet Apple's last-minute changes and orders, thousands more workers were needed overnight, leading to work shifts being increased at short notice.[48] As put by Jennifer Rigoni, Apple's former worldwide supply demand manager, "They [the suppliers] could hire 3,000 people overnight. . . . What U.S. plant can find 3,000 people overnight and convince them to live in dorms?"[49]

It also helped that wages in the Chinese factories were very low. According to CLW's 2013 report, the base wage of Pegatron factory workers in Shanghai was the equivalent of approximately $1.50 per hour.[50] The same report disclosed that most workers wanted to leave the factory after having experienced such harsh working conditions. In one of the Pegatron factories, AVY in Suzhou, more than a quarter of the new workers left within a two-week period.[51]

Offshoring, however, was not looked upon favourably in the United States because it was considered to amount to a loss of job opportunities. In February 2011, when the president of the United States, Barrack Obama, asked Jobs, "Why can't that work come home?" Jobs answered conclusively, "Those jobs aren't coming back."[52] An anonymous executive of Apple gave a sullen response saying, "We shouldn't be criticized for using Chinese workers. . . . The United States has stopped producing people with the skills we need."[53] The company overtly announced that moving work overseas was an inevitable choice and the continuing relocation of jobs was driven not only by lower costs.[54]

Despite the public controversy about Apple's choices and the loss of domestic job opportunities in the United States, the relocation seemed to make perfect sense. Offshore suppliers in China, India, and elsewhere had a proven ability to produce what was needed, whereas the United States did not have enough capable and skilled workers.[55] To some extent, it was simply a numbers game. But Apple also argued that it could produce more jobs in the United States through offshoring because American workers could then focus on higher value-added activities such as research and design.[56]

Offshore outsourcing might have significantly reduced Apple's operating costs. At the same time, however, it also decreased Apple's level of control and monitoring over manufacturing processes and practices.

Although Apple prepared codes of conduct and enforced its suppliers to comply with those standards, in the absence of day-to-day monitoring, compliance was difficult to ensure. Of course, this problem was faced not only by Apple; Samsung and other smartphone producers often sourced from these same factories. But doing so represented a fundamental trade-off that any such firm would need to deal with.

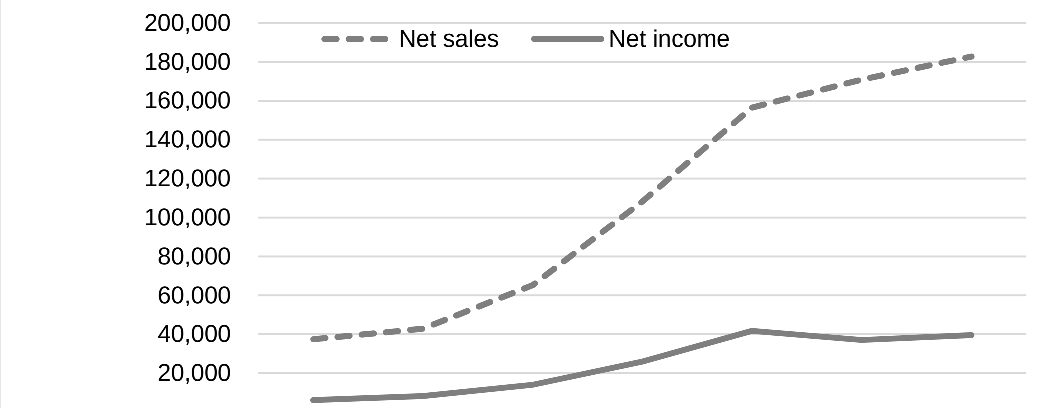
SHOULD APPLE CARE?

The CSR failures did not seem to affect Apple's business performance. In 2015, it topped the *Forbes* list of "The World's Most Valuable Brands,"[57] and ranked 12th in the "Global 2000" list,[58] and 55th among America's Best Employers.[59] Furthermore, it still had unshakable customer loyalty that did not seem to have been negatively affected by the alleged socially irresponsible actions of its key suppliers. This situation invited the question: How much should Apple really care about socially irresponsible actions of its suppliers?

THE ROAD AHEAD

Given the circumstances, Apple and Williams still had several options available. But what option would give Apple the best outcomes? Should Apple continue as it was and take for granted the occasional bit of negative publicity? The company had perhaps already done more than its fair share to tackle CSR problems in its supply chain.[60] On the other hand, maybe Apple could, and should, do more to tackle what had turned out to be a complex issue. Should Apple seek to work more to improve working conditions, such as by working with NGOs and transnational organizations? Should it engage in even more monitoring? Perhaps it could even go so far as to bring production in-house, in an attempt to regain control. A more radical solution would be to bring manufacturing back to the United States, which might become possible in the future, given increased levels of automation and robotization. But how would such changes affect Apple's profit margins — and perhaps even more importantly, would Apple's many customers in China respond negatively to such a move?

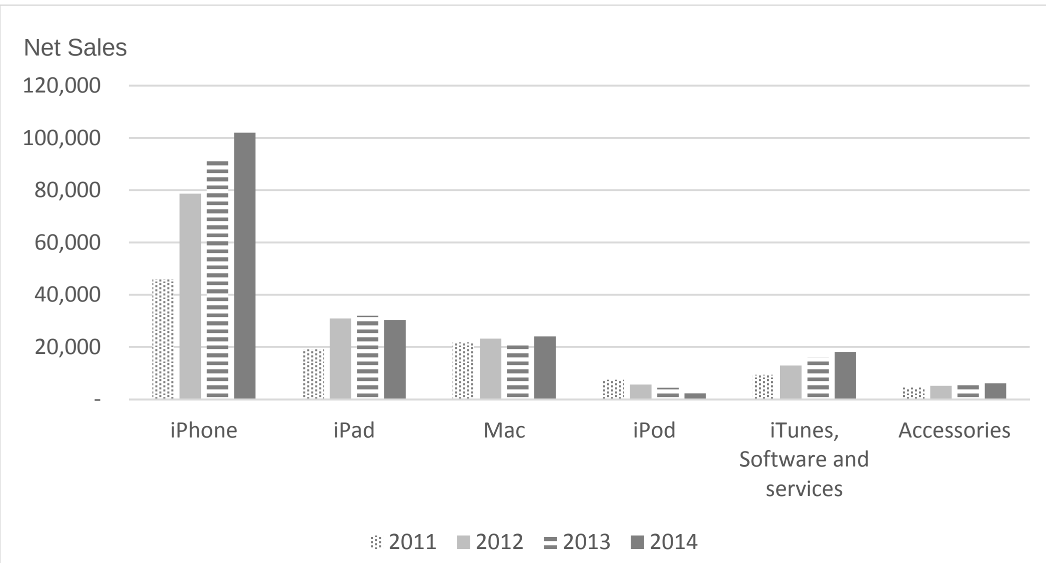
EXHIBIT 1: APPLE'S NET SALES AND NET INCOME, 2008–2014 (IN US$ MILLIONS)



	2008	2009	2010	2011	2012	2013	2014
Net sales	37,491	42,905	65,225	108,249	156,508	170,910	182,795
Net income	6,119	8,235	14,013	25,992	41,733	37,037	39,510

Source: Apple Inc., "Form 10-K: For the Fiscal Year Ended September 27, 2014," EDGAR Online, accessed December 17, 2015.

EXHIBIT 2: APPLE'S NET SALES BY PRODUCT, 2011–2014 (IN US$ MILLIONS)



Source: Apple Inc., "Form 10-K: For the Fiscal Year Ended September 27, 2014," EDGAR Online, accessed December 17, 2015.

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