

## Two Faces of Apple

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## The Good Apple



*Factory workers assembling fiber optics systems in China. CREDIT: jurvetson*

From one perspective, Apple's world could not be rosier and its future shinier. Rising from the rubble of a disintegrating company in 1997, Apple has reached the pinnacle of success in 15 short years. With a market capitalization of over \$500 billion, Apple is amongst the most valuable and highly profitable companies in the world.

Its remarkable success lies in the company's ability to create truly innovative products with vast customer appeal. Apple flouts the conventional wisdom of the consumer electronics industry, which emphasizes low cost, "me-too" products, and a continuously shortened product life. Instead, Apple has opted for constant and discrete product innovation, resulting in fanatic consumer loyalty and a high level of

profitability.

## The Bad Apple

So why does Apple treat its customers and workers by two different standards? When it comes to customers, Apple is a bold innovator that leads the industry into new directions and forces others to follow. However, when it comes to the management of its supply chain and treatment of workers in the Chinese factories that make its products, it hides behind the constraints of prevailing industry practices. What is even more disconcerting is the fact that these practices are in violation of not only local and national laws, but also of Apple's own voluntary self-imposed code of conduct. It is important to note that this voluntary code of conduct breaks no new ground. It is at best a modest attempt to ensure that workers will be treated fairly and provided with a safe work environment.

Yet the violations continue, despite years of monitoring factories where Apple's own audits show persistent non-compliance and despite these factories' repeated broken promises to improve.

## Apple's Strategic Profile - Value Culture vs. Cost Culture

In my view, Apple's good and bad sides both emanate from the same business philosophy: adroit exploitation of market power for the sole benefit of the company and its investors. This model does not consider "what is fair" but what is competitively achievable in higher prices for products sold and lower costs for products made.

**Value Culture:** When it comes to customers, Apple applies the notion of value, i.e., a pricing strategy that is driven by its focus on the value—real and perceived—to its customers. The customer is willing to pay a price that is equal to the product's perceived value to the customer. Hence, as long as the customers are satisfied, Apple is under no obligation to reduce its prices.

**Cost Culture:** When it comes to workers' wages and working conditions, Apple uses its dominant market position (buying power) to acquire these services at the lowest possible price, thus keeping the largest share of the profit for itself and yielding the lowest possible share to the workers. It is not important that the added costs of better wages and working conditions represent an infinitesimally small proportion of the overall costs. It's all relative; if these additional costs are higher than those of Apple's competitors, they could adversely impact the company's stock price in the short run.

In sum, Apple's business model is no different than its competitors. Yet as an industry leader, it surely has the ability, and I contend the obligation, to set standards of conduct that enrich the "commons" at the same time as it enriches the company's investors.

## High-Tech Industries, Apple, and Foxconn

Until around 1995, high-tech companies operating in China remained below the radar with regard to their labor

practices. Initially, these companies were concentrated in Shanghai and somewhat removed from the hotbed of labor issues in the coastal areas. This situation, however, changed once these factories expanded to Shenzhen and other coastal areas. The tech-oriented companies also created enormous scale in tightly integrated production facilities often employing over 50,000 workers. These factories were highly secured to protect new products and production processes from competitors, which allowed companies to prevent outsiders from looking into their labor practices. Foxconn is one of the most successful examples of this type of operation in China.

Foxconn and its China-based subsidiaries are owned and controlled by the Taiwan-based Hon Hai Precision Industry Co., Ltd. Foxconn is primarily an original equipment manufacturer (OEM). It is a joint-design, joint-development, manufacturing, assembly, and after-sales services partner for most major consumer electronic companies in the world. Now a Fortune 500 company, it was founded in 1974 by Terry Guo to integrate manufacturing of electronic products at the lowest total cost.

Foxconn is the largest and most technically sophisticated manufacturing operation for consumer electronic products. In addition to Apple, its clients include, among others, Dell, H.P, Sony, Intel, and Microsoft. The company is the single largest exporter of products from China.

Foxconn is fanatic about secrecy and security. Entry to its plants and other facilities is almost impossible without specific permission of the plant management and authorization from the foreign buyers. This secrecy was well suited to the interest of Apple and other hi-tech foreign companies who were concerned about protecting their intellectual property and new innovative products from their competitors. It also provided Foxconn with a ready excuse for shielding all aspects of its operations.

#### Apple's Problems in China

Most of Apple's worker-related problems were focused on Apple's manufacturing partner Foxconn and its subsidiaries. Apple's China operations first caught international attention in June 2006 with a long story in Britain's Mail on Sunday.<sup>1</sup> This was followed by a spate of similar stories in other leading international news media, and has continued to this day.<sup>2</sup> Because of Foxconn's secrecy, it is well-nigh impossible to develop an accurate assessment of the problems in the factories owned and operated by Foxconn and its various subsidiaries. However, a brief description of extreme conditions prevailing in these factories and widely reported in the media should give the readers some indication of the enormity of the problems that are likely to exist in those plants.

Reports over the past few years have described instances of Foxconn employees committing suicide, presumably from working in an extremely high stress environment. In addition there are reports of deplorable living conditions, underage workers, below-standard wages, involuntary labor, and health hazards associated with the use of toxic chemicals and inadequate air filtration systems. In 2011, there was also an explosion at the plant in Chengdu that killed three and injured 15 workers. Other reported instances of questionable conduct include bribery, falsified records, and adverse health effects amongst workers due to exposure to harmful chemicals like n-hexane. These activities were also identified in Apple's own previous audits.

It should be emphasized that accusations against Apple's operations were quite similar to those made against other foreign buyers of consumer electronics in China. Moreover, they followed a pattern that echoed the findings over the previous decade or more in clothing, shoes, and toy industries in China and other low-wage, surplus labor countries, such as Vietnam, Indonesia, Thailand, and the Philippines. In other words, hi-tech foreign buyers did not distinguish themselves in terms of better treatment of workers. Instead, they eagerly followed the playbook developed by their predecessors in the low-tech, low-wage industries with the added problem of exposing workers to toxic materials under unsafe conditions.

Apple's response patterns to the mistreatment of workers are also the mirror image of its industry peers, with nary a sign of Apple's vaunted innovative culture. Each incidence of complaints has been followed by Apple shipping a team of auditors to China, who would find all the obvious violations, which were already known to Apple from earlier visits. Every time, the company promises corrective action including training of the China partner in human resource management. The entire process is slow and deliberate and its intensity fades in direct proportion to a decline in media attention until the next phase, when the entire cycle is repeated ad nauseum.

In the early stages of this ritual, Apple, like most other companies, was adamant about not disclosing the names of its

China partners. Now, however, Apple and some other hi-tech companies have decided to do so—but only after the names had already been made public by news reports and other labor and consumer watchdog NGOs [non-governmental organizations].

Finally, in the closing days of 2011, Apple announced with great fanfare that it had joined the Fair Labor Association (FLA) and asked it to conduct an independent and comprehensive audit of the Foxconn facilities. Apple promised to make FLA's findings public and to take appropriate action. However, if past experience with FLA is any guide, Apple's faith is misplaced. Founded in 1999, FLA has low credibility among most knowledgeable civil society organizations with long experience with worker-related issues in Asia and Latin America. Its board is dominated by industry representatives who exercise strong influence with regard to which plants are audited, the scope of individual audits, public disclosure of findings, and verification of corrective action.<sup>3</sup>

On his first visits to Foxconn in February 2012, before the audit was even completed, FLA president Aurret van Heerden said that Foxconn's Apple iPad plant was "first class."<sup>4</sup> On March 29, FLA published its final report. By all accounts, it has been a massive undertaking, which according to FLA is "equivalent to a full-body scan of 3,000 staff hours investigating three [Foxconn] factories and surveying more than 35,000 workers."

However, based on my extensive field audit experience in China and those of most other NGOs and human rights organizations, one has to be quite skeptical about the saliency of information gathered through mechanized multiple choice questions and "focus" group interviews. It should be noted that over the years, Chinese factories have honed their tactics in concealing problems from the auditors by keeping workers away from plants during audit visits, maintaining multiple sets of accounting books and workers' personnel files, coaching workers to give right answers to the auditors' questions in terms of working hours, wage rates, and overtime, et cetera, with promises of bonuses if the auditors were satisfied and implied threats of punishment if serious problems were identified. Thus a highly choreographed audit allows for certain violations—albeit manageable—to be disclosed and promises for corrective action to be taken.

As expected, FLA's final report found all the obvious problems, which had already been identified in Apple's own previous field audits. One will have to wait to see the extent to which Apple and Foxconn will address extensive infrastructure problems that are embedded in the cost and manufacturing structure of Apple's supply chain and those of other hi-tech companies in China. Otherwise, we will be visiting the same issue over and over again and with similar findings and promises of corrective action.

Like every company, Apple faces five types of external pressures that influence its strategies and operational policies: customer loyalty; industry best practices; expectations of major shareholders and the investment community; civil society organizations or NGOs; and, increased government pressure and regulatory oversight.

Despite extensive media coverage, Apple has suffered no loss in demand for its products, which continues to grow unabated. Apple also enjoys broad customer loyalty in China even though customers there have a better knowledge of these working conditions. This is not surprising. Product boycotts are usually very short-lived, except those for products that pose a threat to consumers' health and safety, such as contaminated food products. Public pressures and media coverage also decline when the issue ceases to be a news event and other more newsworthy items catch media attention. It is highly doubtful that it will be any different this time.

Apple does not have to fear its competitors because they all use factories with similar cost structures and labor practices. On the contrary, they are likely to be afraid of Apple, since its market power and higher profitability rates provide it with the opportunity to take the initiative in changing industry practices, which other companies would be pressured to emulate.

In the past, institutional investors, notably public employee pension funds, have been aggressive in filing proxy resolutions requiring companies toward greater transparency of their activities in China and other low-wage countries and to initiate measures to improve those conditions—albeit with long-term impact. However, in the case of Apple these voices have been especially muted, as evidenced by Apple's annual shareholders meeting in February 2012.

Civil society organizations and NGOs have also been reluctant to mount a rigorous and meaningful effort to seek a

proactive response from Apple. For example, at the February shareholders meeting, investors successfully gained changes in Apple's board election procedures. Yet none of them raised any questions about the labor situation in China.

Apple does not have to worry about regulatory interventions and oversight either. Although, there are strict laws with regard to wages and working conditions, they are seldom enforced. A similar situation exists with regard to the U.S enforcement of relevant regulations.

There are no easy or quick fixes to create a sustainable improvement in the treatment of workers and workplace safety as covered under the Chinese employment law and Apple's own voluntary code of conduct. I submit that all efforts to date by Apple and its competitors, as well other foreign companies buying products in China and in other emerging economies, have focused on controlling the symptoms while avoiding any recognition or discussion of its underlying causes.

**Excessive Working Hours:** Cutting out excessive hours would entail additional costs. For example, a reduction in the average working hours from the current 60-70 hours per week to 48 hours per week would entail approximately a 30 percent + increase in the labor force to maintain the current rate of output. To accommodate these workers, the factory would need to build extra dormitories and related infrastructure, such as kitchens, security guards, laundry, healthcare, and transportation facilities. The capital investment could be quite substantial and yet "non-productive," i.e. it would not add to production capacity, or manufacturing efficiency, and thus would be reflected in higher production costs.

**Overtime Hours:** In general, workers do not like fewer overtime hours because it lowers their income. Factory owners love to keep regular wages as low as possible so as to incentivize workers toward overtime work. From the factory owners' viewpoint, the real cost is the average wage per hour, and the distinction between regular and overtime wage rates is a tactic to make workers put in more hours.

**Health and Safety Pertaining to Production Facilities:** These issues are also embedded in the prevailing manufacturing system and occur for reasons that are similar to wages and working hours. Improving physical factory conditions, e.g. better air filtration system, better work stations, and provision of safety equipment would require additional factory space, which is "non-productive" capital, and would increase operating costs without commensurate increase in the number of units produced per worker, per hour, per machine, or other measures of productive efficiencies and cost controls.

For these changes to be effective, Apple and foreign multinationals must have agreement with major factory owners. This would require voluntary, but rigorously monitored and sufficiently transparent actions, to minimize the problem of free riders on both sides. This system, at least in the initial stages, would require independent external monitoring, transparency, and verifiable compliance (not the type provided by organizations like FLA). The effectiveness of the system would require the two groups to play key leadership roles: large factories and large multinationals.

From Apple's perspective, the issues of workers' wages and working conditions have been an unnecessary distraction that must be minimized, if not avoided. In the absence of strong and persistent disapproval of Apple's three main constituencies—i.e., customers, stockholders, and regulators—Apple does not feel impelled to go beyond the minimum because there are no apparent and measurable positives that could be expected from choosing any other course of action.

In my opinion, the one important element in this equation is the evolving nature of corporate culture and in particular the character of its new leadership, i.e., new Apple CEO Tim Cook and his own perception of what Apple should be in the larger world of public policy and social good. Former CEO Steve Jobs may have been aesthetically brilliant but he was morally vacuous and his understanding of the working conditions in China was somewhat distant. Tim Cook was the architect of Apple's supply chain and claims to have "ground level" understanding of the working conditions in the Chinese factories. One would hope that he can, and will, play a pivotal role in molding Apple's corporate culture to address Foxconn-like working conditions by attacking their root cause rather than merely treating symptoms.

This would call for Apple to play a leadership role and thereby solidify its reputation not only as a leading corporate

innovator, but also as a leading socially responsible corporate citizen. One hopes that Apple will once again astonish the world by showing a new approach to building better bridges between private profit and public good. This cannot be said yet of Tim Cook. One can only hope that he will respond differently in the future.

In conclusion, I submit that the justification of private enterprise and competitive markets does not rest solely on the profitability of its leading protagonists, but ultimately, on the impact of their activities on the well-being of all stakeholders and society-at-large. Otherwise, it would lose its social license to pursue its business activities and thus necessarily invite greater level of public scrutiny and accountability, which it must, and to its own detriment and that of society. In today's pluralistic society, corporate participation in social policy is not a luxury but a necessity. Furthermore, this participation must not be construed in narrower terms of enhancing corporate profits, but in broader terms of creating a healthier and wealthier "commons" where growth of income is congruent with a fairer distribution of income based on the value contribution of different factors of production.

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## NOTES

1 See <http://www.macworld.co.uk/mac/news/?newsid=14915> for summary of this article.

2 See for example, "[In China, Human Costs Are Built Into an iPad](#)," Charles Duhigg and David Barboza, The New York Times, January 25, 2012.

3 See "[Critics Question Record of Monitor Selected by Apple](#)," Steven Greenhouse, The New York Times, February 13, 2012.

4 See "[Apple iPad plant conditions better than the norm: agency](#)," Terril Yue Jones, Reuters, February 15, 2012.

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