Chapter 16

Outsourcing and Offshoring

A key strategic decision for an MNC is the choice between internalisation and externalisation for every activity in the value chain. This strategic choice raises the question of what is the appropriate value chain architecture of a firm. In the context of internationalisation or even globalisation new options such as offshoring have emerged. The purpose of this Chapter is to highlight the importance of corporate boundary and location decisions and to describe the variety of alternatives.

Internalisation vs. Externalisation

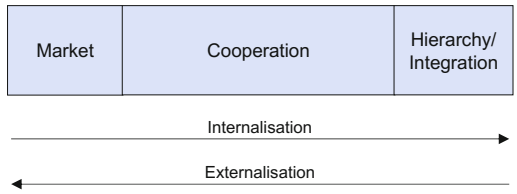
Market vs. Hierarchy

In *new institutional economics* (for theoretical explanations, see Chapter 14) there are two opposing choices for realising activities. A value chain activity can be performed internally, i.e. controlled or coordinated via hierarchy/integration, or externally, i.e. by other firms. Externalisation always means *buying* or *sourcing* goods or services. In this case, the *market mechanism* assumes the role of coordination (see Figure 16.1). In more practitioner-oriented terminology these two basic alternatives are also called *make or buy* (see Zentes/Swoboda/Morschett 2004, pp. 243-250).

If an activity currently being realised internally is transferred to an external firm, this process is called *outsourcing*, i.e. the use of outside resources. In contrast, if an activity is integrated into the internal value chain (intra-firm transaction), this process is called *insourcing*.

Transaction Modes

Figure 16.1



D. Morschett, H. Schramm-Klein, J. Zentes, *Strategic International Management*, DOI 10.1007/978-3-658-07884-3_16

Between these two polar alternatives there are a wide range of *cooperative agreements* (see Chapter 17) with only vague delimitations between externalisation and internalisation, such as *contract buying, contract manufacturing, licensing, franchising* or *equity joint ventures*.

Advantages and Disadvantages of Outsourcing

The strategic choice between internalisation (insourcing) or externalisation (outsourcing) affects all activities in a firm's value chain.

Motives

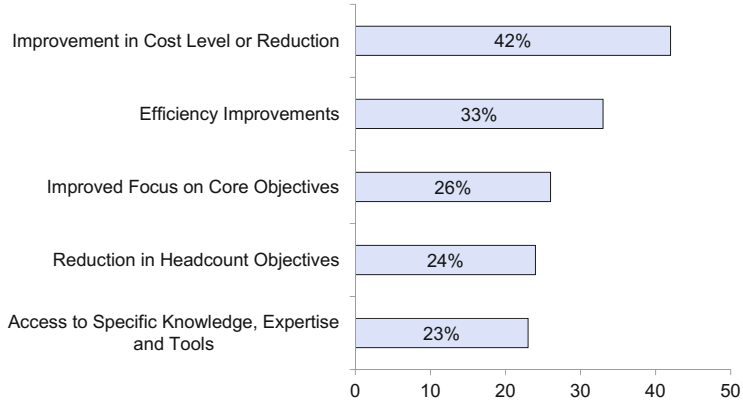
In a *meta study* of the scientific literature, Matiaske and Mellewigt (2002, pp. 646-647) identified four main *motives* for outsourcing:

- *Cost advantages:* A major motive for outsourcing is cost reduction. The logic behind this argument is that an external firm can realise the function in question more efficiently than the outsourcing firm, because the firm is specialised in this field, i.e., the activity belongs to its core competences. The assumption is that the external firm is willing to transfer this cost advantage completely or partly to the outsourcing firm.
- *Concentration on core business*: From a strategic point of view, a strong concentration on core business is another important motive for outsourcing. By outsourcing minor/peripheral or supporting activities, a firm can focus its resources on the core activities of the value chain.
- *Improvement of efficiency and performance*: Bringing in external service providers can lead to performance improvements. Specialists are likely to have better expertise, better qualified personnel and be more technologically up-to-date than the outsourcing firm.
- *Advantages in financing and risk transfer*: Outsourcing activities related to high financial investment, reduces the amount of capital tied up and the firm's funding requirements. At the same time, the financing of reserve capacities in order to meet peaks in demand can be dropped. Finally, fixed costs are "converted" to variable costs.

A recent *Ernst & Young* (2013) study across eight European countries identified the most important reasons for outsourcing business processes and IT services. Improvements in *cost levels* is still the most frequently cited reason for outsourcing. "Efficiency improvements and a greater focus on core business are the second and third reasons for outsourcing within Europe" (Ernst & Young 2013, p. 14) (see also Figure 16.2).

Most Important Reasons for Outsourcing

Figure 16.2



Source: Ernst & Young 2013, p.15.

Risks

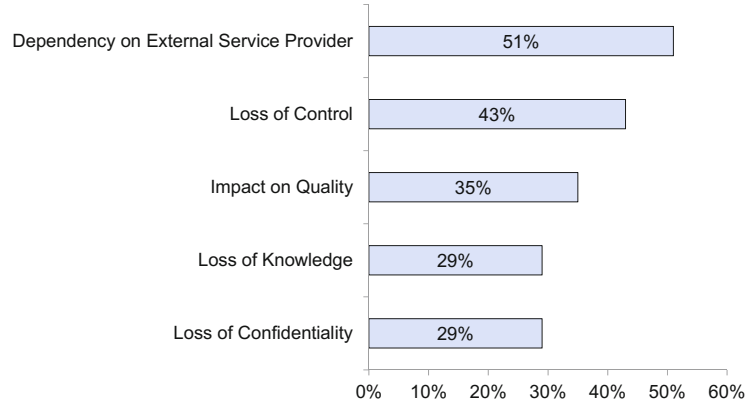
Matiaske and Mellewigt (2002, p. 651) identify the following *risks* of outsourcing:

- *higher total costs* than alternatives due to *transaction costs* (costs of negotiating, control, etc.)
- *opportunistic behaviour* by the firm (supplier) to which an activity has been transferred
- *loss of expertise*
- *transfer of core competences*.

This last risk describes a situation where core competences are not recognised as such and transferred externally.

As shown in Figure 16.3, *dependence on the external service provider* is perceived as the most important risk when organisations outsource, following the recent *Ernst & Young* study (2013). These results largely correspond to the findings in the meta-study by Matiaske and Mellewigt (2002).

Figure 16.3 *Most Important Risks for Outsourcing*



Source: Ernst & Young 2013, p. 15.

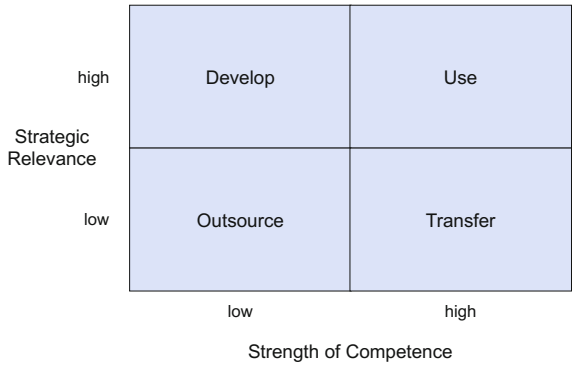
Strategic Relevance/ Competence-Matrix

Outsourcing can also be positioned in the so-called *"strategic relevance/competence-matrix"*, developed by Krüger and Homp (1997) (see Figure 16.4). Following this model, outsourcing is useful if the strategic relevance or importance and the firm's competence with regard to an activity or process are low ("outsource"). This situation is typical for support activities, such as facility management, legal services or payroll services. If the strategic relevance is high but the firm's competence in this field is low, the firm has to invest in order to narrow the gap ("develop"). The competence can be transferred, i.e. sold, to other companies, even competitors, if the firm's capabilities are high and this asset is not crucial to market success ("transfer"). The combination of high competence and high strategic relevance forms the basis of *competitive advantages*. Activities or processes in this field are realised internally, rather than outsourced or transferred ("use").

When the right outsourcing decisions are made, the resulting benefits serve to strengthen the company's internal resources (Nordin 2008). So outsourcing allows the company to concentrate on the business activities that create greater competitive advantages for them.

Strategic Relevance/Competence-Matrix

Figure 16.4



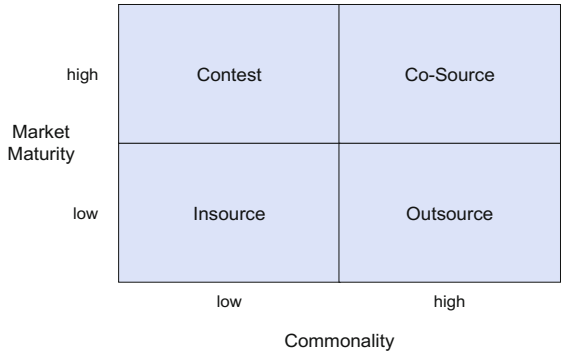
Source: Adapted from Krüger/Homp 1997, p. 105.

There is not one single outsourcing model. The "*A.T. Kearney* Strategic Outsourcing Framework" (Martin 2010) shows different *strategic choices* (see Figure 16.5):

- *outsource*: Services are provided by a third party.
- *co-source*: Services are provided by one or more providers.
- *contest*: Services are contracted to multiple suppliers at the same time.

A.T. Kearney's Strategic Outsourcing Framework

Figure 16.5



Source: Martin 2010, p. 165.

New Forms of Value Chain Architecture through Outsourcing

Decisions in the field of internalisation vs. externalisation lead to fundamental changes in a firm's *value chain architecture*. Three typical architecture types for core processes can be found:

- *traditional* architecture type
- *assembler* architecture type
- *coordinator* architecture type.

Traditional Architecture Type

The traditional model, characterised by supply chain processes and the market-oriented processes which are realised internally, is still common in specific industries, such as the chemical and pharmaceutical industries. At first glance this type operates in most industries, but the degree of *vertical integration* has been dramatically reduced.

Assembler Architecture Type

In the automotive industry, the average degree of vertical integration is between 20 and 30%. The production of parts or components has been transferred or outsourced to suppliers. For example, a typical car contains more than 10,000 components. In this industry manufacturers constantly face make-or-buy decisions: "*Toyota* produces less than 30% of the value of cars that roll off its assembly lines. The remaining 70%, mainly accounted for by component parts and complex subassemblies, comes from independent suppliers" (Hill 2013, p. 424).

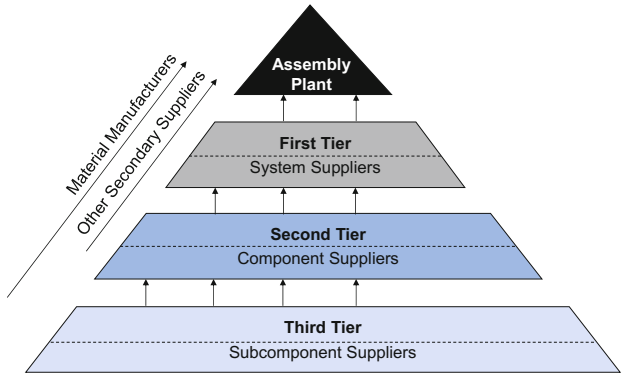
Reducing the degree of vertical integration leads to the *assembler* type. This type is characterised by large amount of outsourcing, but the assembler controls the *total value chain*, i.e. its own value chain as well as the basic parts of its suppliers' value chains. The assembler coordinates R&D, sourcing, production and logistics activities. For R&D the (outsourcing) firm is responsible for *innovation management*, while for production and sourcing they are responsible for *quality management*.

Supplier Pyramid

Due to the division of labour between a manufacturer and its suppliers, *supplier pyramids* are characterised by several layers of contractors or subcontractors. The *tier structure* of this supplier network is illustrated in Figure 16.6.

Supplier Pyramid

Figure 16.6



The *assembler* type of value chain architecture shows the fuzzy delimitation between externalisation and cooperative agreements. Two sub-types can be distinguished:

- contract buying
- contract manufacturing.

Contract buying is characterised by suppliers offering products and/or services developed and designed on their own and delivering these goods on the basis of mid-term or even long-term agreements *(contracts)*. Sourcing of raw materials and energy is typical for this type of agreement. *Contract manufacturers* produce parts or components which are developed and designed by the outsourcing firm (see Morschett 2005; see also Chapter 17). In some cases, they have no R&D activities of their own.

Coordinator Architecture Type

Manufacturers without Production

The farthest-reaching type of outsourcing is typical for the value chain architecture of a *coordinator* or "*orchestrator*". This architecture occurs when a manufacturer undertakes no production activities at all, i.e., all production has been outsourced. The *coordinator* type is becoming more prominent, especially in the consumer goods industries. Companies such as *Ralph Lauren, Nike, Adidas* and *Puma* concentrate on product development, design and the control of the supply chain. Their production activities are totally transferred to suppliers operating on a *contractual basis*. The same tendency can be observed in the electronic industries (see the case study in this Chapter).

Coordinating Store Brands

The value chain architecture of a coordinator is not only relevant to manufacturers. A growing number of retail and wholesale companies are adopting this form, migrating from the traditional architecture (buyer) to that of a coordinator. The development and design of *store brands* produced by contract manufacturers is an example (see, e.g., Zentes/Morschett/Schramm-Klein 2011, pp. 232-237).

Insourcing through Verticalisation

Secured and Controlled Distribution

Marketing, especially selling/distribution, displays a completely different trend, especially in the consumer goods industries. Manufacturers are increasingly integrating direct sales activities into their value chains by establishing their own outlets (*equity stores*) or retail chains or by selling directly to consumers via the Internet *(E-Commerce)* (Zentes/Swoboda/Morschett 2005; Zentes/Neidhart/Scheer 2006). As well as this form of *secured distribution*, there is a wide range of *contractual agreements* with legally independent retailers or dealers *(controlled distribution)*, for example, franchise agreements or shop-in-shop agreements (see Zentes/Morschett/Schramm-Klein 2011, pp. 98-104).

Insourcing market-oriented activities, such as selling to final consumers (*B2C-distribution*), are frequently combined with the supply chain oriented architecture of a coordinator. The companies mentioned above (*Ralph Lauren, Nike*, etc.) are pioneers in this field. In the extreme case, a manufacturer has no production of its own and a pure controlled distribution network. It "only" coordinates the supply chain and market-oriented processes.

Offshoring

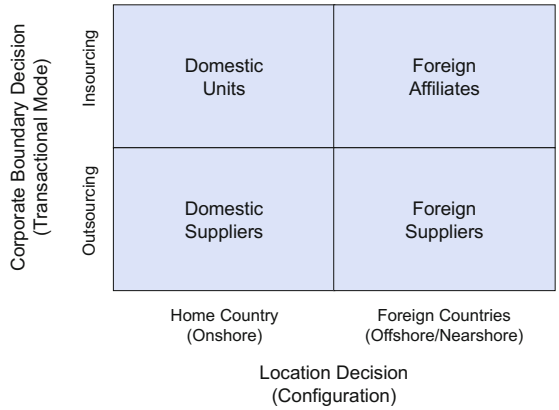
Corporate Boundary and Location Decisions

While outsourcing involves the decision of whether to make or buy (*corporate boundary decision*), neglecting cooperative transactional modes regardless of where the activity takes place, the location decision (*configuration decision*) refers to where the activity takes place regardless of whether it is inside or outside the corporate boundary (see Figure 16.7).

Offshoring refers to relocating activities to foreign countries, mostly low-cost countries, e.g. *newly industrialised countries* (NICs) that are emerging as production sites, sourcing and/or selling markets. This offers the opportunity for international production and international sourcing to make use of comparative advantages, such as low wages (see Chapter 19). The literature sometimes draws a distinction between *offshoring* and *nearshoring*. Offshoring refers to remote, lower cost locations, nearshoring to nearer lower cost countries.

Transactional Modes and Configuration

Figure 16.7



Source: Adapted from Abramovsky/Griffith 2006, p. 595.

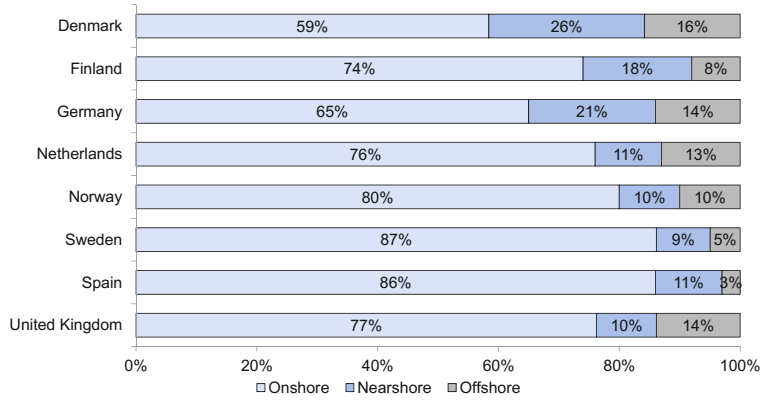
Locations of Outsourced Activities

The previously mentioned *Ernst & Young* study (2013, p. 13) identified three options for *locations of outsourced activities* (see Figure 16.8):

- *onshore*: provided from the same location or country
- *nearshore*: provided from another country in the same continent
- *offshore*: provided from an offshore location, usually located in Asia, the Middle East, Africa or Latin America.

Denmark has the highest percentages provided from offshore (16%) and nearshore (26%), followed by Germany with 14% and 21% respectively.

Figure 16.8 *Location of Outsourced Business Processes and Services by Country*



Source: Ernst & Young 2013, p. 13.

Emerging countries are mostly interested in attracting foreign capital and expertise by establishing plants or R&D units in order to accelerate the economic transformation and development process or to produce and deliver to foreign countries in order to create values and reinforce their home labour markets. Therefore they support or even sponsor such activities or processes through tax reductions or temporary tax concessions which increase the *comparative advantages* of these countries. Sometimes they establish special *tax free areas*: territories with exemption from duties, often geographically connected with ports, to attract foreign production sites (see also Chapter 8).

Offshoring/Outsourcing of Management and Support Activities

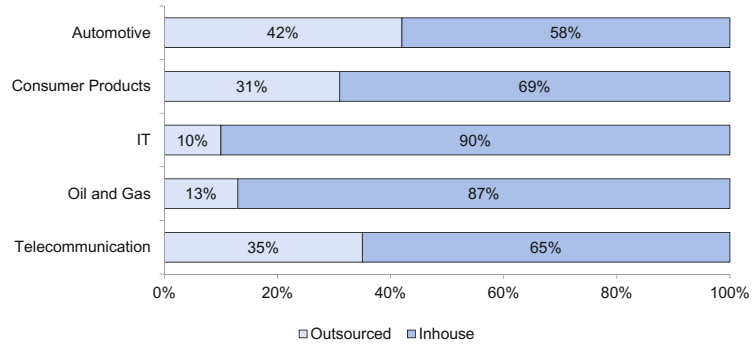
In recent years, the outsourcing decision has gone beyond the production of physical products. Outsourcing also refers to support and service activities as well as management process activities, such as human resource management, information management, etc. ("moving *white collar jobs* offshore"). This field of *management and support activities*, also combines the corporate boundary decision to outsource with the location decision of offshoring, e.g. to prefer suppliers in low-cost countries. "For example, many US-based companies from credit card issuers to computer companies have outsourced their call centres to India. They are 'buying' the customer call centre function, while making other parts of the product in house. Similarly, many information technology companies have been outsourcing some parts of the software development process, such as testing computer code written in the

USA, to independent providers based in India. Such companies are 'making' (writing) most of the code in-house but "buying", or outsourcing, part of the production process (testing) to independent companies"(Hill 2013, pp. 424-425).

As an example, Figure 16.9 shows the degree of outsourcing of IT services per industry. IT services are outsourced most in the automotive industry, followed by the telecommunication and consumer product industries.

Outsourcing of IT Services per Industry

Figure 16.9



Source: Ernst & Young 2013, p. 12.

Vertical Integration and Re-Location as Counter-Trends

"Every trend engenders a counter-trend." When it comes to outsourcing and offshoring, some important strategic developments can be observed. Due to the dramatic expansion of the world population and the consequent growing demand for agricultural and industrial raw materials, *supply security* is increasingly important, leading to long-term contracts with suppliers, e.g. farmers (*contract farming*), or even acquisitions of suppliers in this field (Zentes 2011).

This tendency towards insourcing is triggered by a quite different factor. Pursuing the aim of being a *sustainable player*, i.e. operating in a socially and ecologically responsible manner, ultimately requires total control of all value chain activities, including preliminary stages of the production process. This

can be achieved through complex and costly control mechanisms or by insourcing (Bastian/Zentes 2011).

Sometimes these requirements lead to re-location of production or sourcing activities to countries which guarantee or enable compliance with social and ecological standards (nearshore), or even back to the home country.

Conclusion and Outlook

Outsourcing and Insourcing

An asymmetrical tendency can be seen in value chain architecture. On the one hand, outsourcing or externalisation is the strategic mainstream for the supply chain process, which results in new value chain models such as *assembler* or *coordinator*. On the other hand, companies are interested in controlling or even securing the distribution in order to have *direct relations* with private and/or commercial customers. This strategic approach leads to new marketing and sales structures – insourcing or internalisation is the consequence.

The political and legal developments in the context of globalisation reinforce the tendency of offshoring, i.e. shifting production and/or sourcing to foreign countries. Companies in high-cost countries are increasingly concentrating on *intellectual value creation*, i.e., innovation management, quality management and brand management, which increasingly includes *channel management*.

Some triggers of insourcing and re-locating can be observed: securing supplies of agricultural and industrial raw materials and ensuring social and ecological standards in the value chain process.

Outsourcing Dilemma

Offshore production or *offshore sourcing* sometimes results in one of the biggest challenges facing international business or managers of international companies: defining ethical standards and operating in a socially and ecologically responsible manner (Griffin/Pustay 2013, pp. 143-149, see Chapter 13). Companies are often faced with real *ethical dilemmas* where the appropriate action is not clear: "They are situations in which none of the available alternatives seems ethically acceptable" (Hill 2013, p. 132). "For example, at a first glance, it is uncritical for a company to outsource production to a factory in a low-cost country with unsafe working conditions". But people in that country might argue that as unattractive as they might seem to outsiders, those jobs are superior to the ones that would otherwise be available" (Griffin/Pustay 2013, pp. 142-143).

Further Reading

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Case Study: Foxconn*

Profile, History and Status Quo

Hon Hai/Foxconn Technology Group, better known by its trading name *Foxconn*, is a multinational electronics contract manufacturer headquartered in Tucheng, New Taipei, Taiwan. The enterprise group (hereinafter collectively called *Foxconn*) is the world´s largest and fastest-growing company in the field of manufacturing services providers for the so-called 3Cs: computers, communication, and consumer electronics. *Foxconn* is the manufacturer of some of America´s most popular consumer electronic devices for companies like *Apple* or *Microsoft*, and has widespread manufacturing facilities worldwide, but most of all in China. Thus, it is "a symbol of US outsourcing" (EPS 2014).

The company's origin dates back to 1974, when *Terry (Tai-min) Gou* founded *Hon Hai Precision Industry Company Ltd.*, the parent company of *Foxconn*, "guided by the belief that electronic products would be an integral part of everyday life in every business and every home" (Foxconn 2014). Convinced by the idea of providing the lowest cost solutions and thus making electronic products affordable for the entire market, the founder established *Foxconn* with only 7,500 USD, borrowed from his mother. At the end of the 1980s, *Foxconn* opened its main manufacturing plant in Shenzhen, China. In 1991,

* Sources used for this case study include the websites http://foxconn.com, annual and company reports, as well as explicitly cited sources.

the company was listed on the Taiwan Stock Exchange Corporation (TSEC), and is currently worth about 1.1 trillion TWD (37 billion USD).

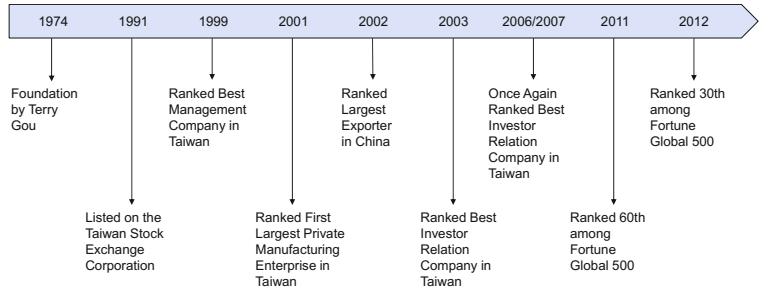
Awards, Nominations and Rankings

Since its foundation, *Foxconn* has been awarded and nominated several times. Among other examples, *Foxconn* was selected as the "Best Management Company in Taiwan" by Asian Money in 1999. In 2001, according to Taiwanese surveys, the company became the largest private manufacturing enterprise in Taiwan, and in 2002 it became the largest exporter in China. According to *IR Magazine,* it has been nominated as the "Best Investor Relation Company in Taiwan" three times, in 2003, 2006 and 2007. In 2011, *Foxconn* was ranked 60th among the "Fortune Global 500" by *Fortune magazine* and 9th in "IFI CLAIMS® 2011 Top 50 United States Patent Assignees" as a leader in innovation and technical expertise. The contract manufacturer was responsible for 5.9% of exports in China in 2011, and was ranked as the largest exporter in the country for ten consecutive years (2002-2012).

Foxconn had been granted more than 55,000 patents up to 2012 – with about 92,000 patents already registered. This made *Foxconn* a recognised leader of innovation and technical expertise in further rankings such as *MIT's* or *IPIQ's* patent scorecard. In 2012, *Foxconn* was ranked 30th among the world's biggest companies by "Fortune Global 500".

Figure 16.10 shows a summary of the *milestones* in *Foxconn´s* history, from its founding until 2012.

Figure 16.10 *Milestones in Company History (from 1974 to 2012)*



Today, *Foxconn* employs some 1.6 million people globally and has production facilities in Asia, Europe, Mexico and South America that together assembled some 40% of the consumer electronics products sold in 2013. The company´s revenue of 132 billion USD for 2013 is estimated to double within the next 10 years.

Visions

The long-lasting success of *Foxconn* is based on the following three visions, which have guided the company since its foundation:

- making electronic product usage an attainable reality for all of mankind through the most efficient *"total cost advantages"*
- revolutionising the conventional inefficient electronics outsourcing model through the proprietary one-stop shopping vertically integrated *eCMMS model*
- achieving a *win-win model* for all stakeholders including shareholders, employees, community and management through a devotion to greater social harmony and higher ethical standards.

Competitive Advantages

Guided by these visions, *Foxconn´s* competitive advantages lie in the aforementioned *eCMMS business model* and its unique *"Foxconnian culture"*. *Foxconn´s eCMMS*, which stands for e-enabled components, modules, moves and services, is the vertically integrated business model formed by integrating mechanical, electrical and optical capabilities. This process means quicker speed to market, higher quality, better engineering services, greater flexibility and cost savings. Moreover, it allows the company to generate solutions ranging from moulding, tooling, mechanical parts, components, modules, and system assembly to design, manufacturing, maintenance and to logistics. On the strength of the *eCMMS model*, *Foxconn´s* Shenzhen Campus in Southern China is both the world's largest 3C manufacturing base and shortest supply chain.

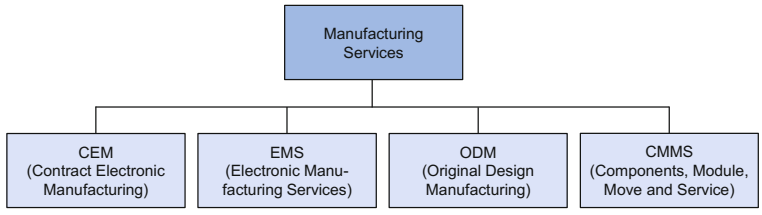
Manufacturing Services and Major Customers

Providing Manufacturing Services

Aided by its business model, *Foxconn* provides four different manufacturing services, including *CEM, EMS, ODM* and *CMMS*. These manufacturing services are shown in Figure 16.11.

The Company´s Manufacturing Services

Figure 16.11



Major Customers

Foxconn provides services for the biggest companies in the field of electronics and information technology. Its clients include American, European and Japanese companies which outsource the manufacturing of hardware or other components in order to lower production costs and withstand competitive pressures. One of *Foxconn's* most important contract partners is *Apple*, as *Foxconn* draws an estimated 40 to 50% of its revenue from assembling their products and other work. It further manufactures components for *Amazon, Dell, Blackberry, Intel, HP, Microsoft,* and many others. A selection of *Foxconn's* major customers is presented in Table 16.1.

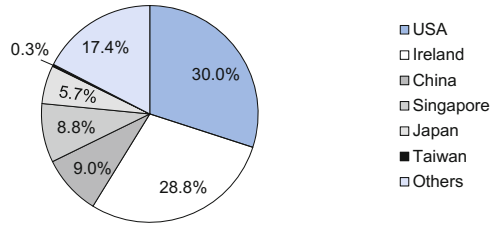
Table 16.1 *Major Customers and Devices Produced by Foxconn*

Customer	Manufacturing Product
Amazon	Kindle
Apple	iPad, iPod, iPhone, Mac mini, Macbook pro
Cisco	Video and Telecommunication Equipment
Dell	Laptops
Hewlett-Packard	Personal Computer, Laptops, Printer
Intel	Mainboards
Microsoft	X-Box, X-Box 360
Nintendo	DS, Wii
Nokia	Components of Mobile Phones
Blackberry	Smartphones
Sony	Playstation
Huawei	Smartphones
Acer	Smartphones

Figure 16.12 shows shares of the company´s revenue by geographic area, based on the location of customers. The vast majority of customers come from the USA and Ireland, which represent more than half of *Foxconn´s* revenues.

Revenue by Geographic Area Based on the Location of Customers (in 2012)

Figure 16.12



Source: Foxconn 2014.

Offshoring to China

After the communist economy opened up, many companies from highly developed countries began offshoring their production to the Far East, and mostly to China, by taking advantage of lower wages and operating costs.

Foxconn, today China´s largest employer, benefited greatly from China's embracing of Western economic policies by receiving outsourcing contracts from *Apple* and other companies. It quickly dwarfed competitors like *Flextronics International Ltd.*, *Jabil* and *Sanmina*, and has become the No. 1 global EMS provider (EPS 2014).

Development in the IT Market of China

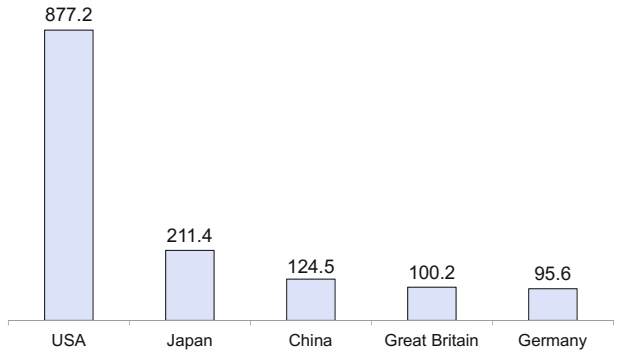
Anchoring and assuring *Foxconn´s* swift growth, the Chinese IT market is of extraordinary importance to its business activities. *Foxconn* owns 13 factories in 9 Chinese cities and currently employs 1.4 million people in China alone. Along with fast growing companies like *Foxconn*, China has become the leading global business location for remote functions, including IT services, support contact centres and back-office support. Since 2010, the IT industry has gained strong momentum, riding a new wave of IT investment.

Software as Growing Service Industry

Based on a new development within China, companies are increasingly seeking improved efficiencies by using software to lower costs and improve productivity. Software is one of China's fastest growing service industries. Since software development creates more manufacturing processes, the Chinese software industry is gaining in importance. With the global economy predicted to expand faster this year, China is expected to further narrow the gap with the industry leaders, the United States and Japan, in the 2 trillion USD global information technology market, shown in Figure 16.13. Total government and business spending in IT on the Chinese mainland is

estimated to increase by 10.5% to 124.5 billion USD in 2014. Multinational companies continue to invest in key IT products sourced from China. US computer giant *Dell*, for example, spends more than 25 billion USD a year on the mainland on manufacturing and sourcing of IT components and related products. Before today, companies focused on China's emergence as an important and successful outsourcing market. In spite of this, making strategic decisions to identify the optimal location can be challenging as every country has its own unique offerings.

Figure 16.13 *Markets for IT Goods and Services 2014 (in billion USD)*



Source: SCMP 2014.

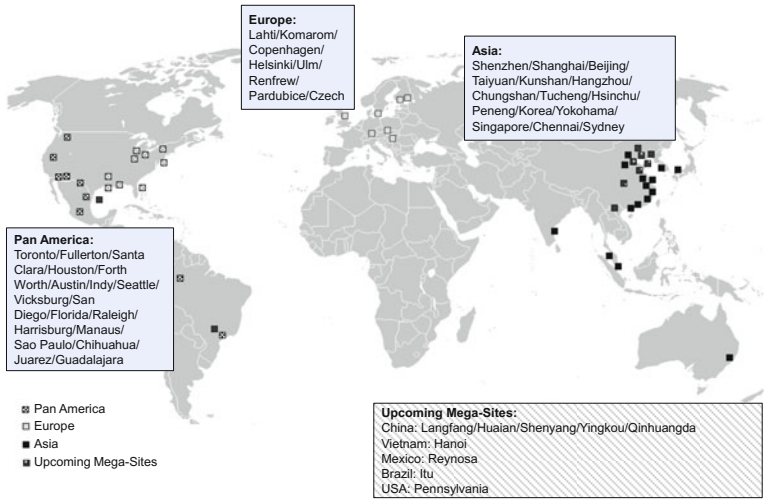
Overall, offshoring covers such a wide variety of nations, products and practices that it is difficult to estimate market size. A significant share of offshoring revenue is created by contract manufacturing of electronics, laptop computers, tablet computers, cellular telephones and items such as *iPods*. Another major sector in offshoring is contract manufacturing of shoes, apparel and accessories. Contract electronics manufacturing is estimated at 404.5 billion USD for 2013, growing to 451.9 billion USD by 2016. Products manufactured offshore for corporations headquartered in the United States, Canada, Japan and other developed nations are frequently intended for sale in offshore markets. For example, offshore electronics contract manufacturing firms such as *Foxconn* produce *Apple's* extremely popular smartphones. While *Apple's* products are sold in North America and Europe, a growing portion of their sales takes place in Asia itself where the products are made. There are definite advantages to conducting manufacturing close to the rapidly growing business and consumer markets of Asia.

Reversing the Offshoring Trend

Despite the extraordinary relevance of China, *Foxconn* has manufacturing operations outside of China. Today, it owns factories and has operating units in more than 10 countries or regions, and plans to further increase production in locations outside of China (see Figure 16.14).

Operating Units (in 2013)

Figure 16.14



Source: Foxconn 2014.

Changing Market Conditions

Foxconn is facing changing economic conditions as manufacturing costs in former low-cost countries like China are rising quickly. For example, in recent years *Foxconn* has been involved in numerous scandals related to manufacturing activities, such as safety issues, bad working conditions and labour disputes in China. The aforementioned *Foxconn* scandals also impacted its contract partners, such as *Apple.* This was particularly apparent in May 2010, when the media reported on the series of worker suicides at a *Foxconn Apple* factory. As a consequence, *Foxconn* started to increase salaries in many of its Chinese manufacturing locations and set stricter limits on workers' overtime.

Increasing costs, growing numbers of natural and man-made disasters and the long tail of logistics have forced *Foxconn* to rethink manufacturing in China. There is now an alternate plan to get *Foxconn's* products to its customers without any interruptions, as lower production costs can quickly be nullified by other problems, if products do not make it to market on time at

an optimum price.

Growing Trend towards Closeness to the Customer

According to *McKinsey's* analysis, locating manufacturing out of China closer to demand makes it easier to identify and meet local needs (EPS 2014). Thus, the development in manufacturing is towards being closer to the customer as it emphasises both proximity to demand and to innovation (McKinsey 2014). *Foxconn's* plan to increase factories in the US also emerged from the reality that customers want greater guarantees than they are currently offered. It represents an opportunity to retain current contracts and gain new ones. Terry Gou, Chairman of *Foxconn,* is seeking to resettle capital-intensive and high-tech manufacturing in the USA. Specifically, *Foxconn* intends to build a display-manufacturing facility, and is further convinced that automation, software and technology innovation will be the priority of US production in the forthcoming years. As well as planning to expand in the US, *Foxconn* intends to make Indonesia a key partner for production: *Foxconn* and *Blackberry* recently entered into a deal to design and market phones in Indonesia. In addition, *Foxconn* is investing 10 million USD into a venture with *Carnegie Mellon University* for research into robotics and manufacturing. Furthermore, *Foxconn* is collaborating with *Google* on a new vision of robotised factories, with *Google* extending its robot technology in general. By getting closer to their customers, *Foxconn* aims to better serve them and to position the company for further growth.

Summary and Outlook

The case study illustrates the relevance of *Foxconn´s* major role as an electronics manufacturer. Since its beginnings in 1974, *Foxconn* has become one of the world's leading exporters of electronics, with major clients including *Apple*, *Cisco*, *Hewlett-Packard*, *Microsoft*, *Dell*, *Nintendo* and *Sony*. In the coming years, automation, software and technology innovation will be the key focus in the United States. The trend towards greater proximity to the customer, and thus getting closer to demand and innovation, includes different factors such as varied and crucial sets of production locations. Efficient partnerships are vital, as well as the availability of technical skills. The transfer of *Foxconn's* production out of China into the United States implies that the offshoring era has reached a peak. Amongst other reasons, this is because recent offshoring strategies have resulted in increasing unemployment rates, making local production a political factor for Western companies. Furthermore, *Foxconn's* customers like *Google* and *Apple* have announced that they want to produce more of their products in the United States. This could put collaborations with pro-China companies such as *Foxconn* at risk.

Questions

1. *Foxconn* is the main contract manufacturing firm for many huge companies in the field of consumer electronics. Discuss the advantages and disadvantages outsourcing brings to outsourcing companies, as well as to *Foxconn*.
2. *Foxconn* wants to set up plants in the United States, reversing the offshoring trend of the last 20 years. Does this shift make sense, and what will it mean for *Foxconn*, its competitors and the entire electronics industry? What opportunities and challenges will *Foxconn* face by extending its activities into the US? What possibilities, opportunities and risks does manufacturing outside of China bring?
3. Discuss the advantages and disadvantages of the collaboration between *Google* and *Foxconn*.

Hints

1. See, e.g., Schniederjans and Schniederjans 2005, pp. 21-35.

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