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Strategic Change and Organization Report
Apple's Expansion in Malaysia

Part A

Submitted by

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1. Executive Summary

In the past twenty years, China has been the market expansion and factory of choice for many U.S. technology companies. However, as a result of the U.S. China trade war and growing geopolitical tensions in recent years, more and more technology companies are expanding their operations and seeking new markets. This paper aims to conduct an internal audit of the health Apple Inc's (hereafter "Apple") internal global business and financial operations, seeking to identify key areas and opportunities for continued growth. It argues that growing tariffs, intellectual property theft and emerging competitors remain major threats to Apple's business model, and that it should lessen its dependency on regional supply chains and susceptibility to regional supply and demand shocks by expanding to the Southeast Asian market. In particular, we identify Malaysia as a promising country for Apple to shift its current supply chain and manufacturing activities, as well as market its products to the growing middle class. After conducting an internal and external audit, Porter's Five Forces Model will be used to analyze Apple's current industry positioning, SWOT matrix and SPACE matrix will be applied for strategy formulation for strategic positioning evaluation, followed by strategy recommendations validated by QSPM. A detailed implementation plan for how best Apple can expand its foothold in Malaysia will also be provided.

2. Introduction

In the first quarter, Apple reported record-level first quarter fiscal year 2020 financial results (which ended on December 28th, 2019). Fuelled by strong demand for its new iPhone 11 and iPhone 11 Pro models, as well as record demand for Apple products such as the Apple Watch, the company announced a quarterly revenue of \$91.8 billion, an increase of 9% from the quarterly revenue in 2018 (Apple Press Release, 2020). It also had quarterly earnings per diluted share of \$4.99, up 19 percent, an all-time record (Apple Press Release, 2020). International sales made up 61 percent of Apple's total quarterly revenue. However, this does not mean that Apple's future is secure. The company faces a number of risks and threats to its business model. The smartphone and technology industry is becoming increasingly competitive, with competitors such as Samsung, Xiaomi and Huawei, threatening to take over Apple's market position. Furthermore, the international business environment is becoming increasingly hostile, with the U.S. – China trade war and countries raising tariffs towards international business. Therefore, in order to maintain its impressive levels of growth, Apple

must aggressively pursue an expansion strategy for its retail and manufacturing business in emerging global markets.

In recent years, Apple has been gearing up to expand its current business operations in Southeast Asia, opening retail outlets in Thailand and Singapore. Given tightening business restrictions in China as a result of the US trade war, and increase in competition from domestic players such as Xiaomi and Huawei, it is not surprising that Apple would go after the Southeast Asian market, especially its fastest growing economies – Malaysia, Singapore, Thailand and Vietnam. The region is home to 650 million consumers, many of whom are moving into the middle class. Apple is also considering shifting manufacturing from China to Southeast Asia. Its relatively low labour costs and tax relief policies also make it an attractive location for many major suppliers.

For the purposes of scope, the paper will focus on Malaysia, one of the so-called ASEAN-5 countries – Indonesia, Malaysia, the Philippines, Singapore and Thailand. These countries are relatively economically developed, and are attractive sites for investment because they have reasonable production costs, stable institutions, improved technological innovation, lowering tariffs and import barriers for production inputs, and increasing labour skills. Apple has clear scope for expansion into the region, as adoption of its products in the region is limited.

This report will deliver a thorough internal and external audit on Apple and its expansion in Malaysia. It will provide a critical overview of the business and political environment in Malaysia (both micro and macro), and identify barriers and issues to strategic expansion, as well as approaches to overcome them.

3. Internal Audit

This section of the report will provide an overview and brief introduction to Apple's internal structure and business model, in order to inform the strategies and best practices for Apple's expansion strategy.

3a. Business model

Apple Inc. is an American public multinational company that designs, manufactures and markets smartphones, personal computers, tablets, wearables and accessories, as well as a variety of related services (Apple Inc., 2019, pp.1). Established in California in 1977 to sell the first Apple I personal computer, it is now the world's largest technology company by revenue and one of the world's most valuable companies. It is the world's third-largest mobile phone manufacturer after Samsung and Huawei (The Guardian, 2018). Apple is a major job-creator.

The company currently employs approximately 137,000 full-time employees (Apple Inc., 2019, pp.3).

3b. Product development and distribution strategy

Apple's main products are the iPhone, the Mac, the iPad, and wearables, home and accessories, which include AirPods, Apple TV, Apple Watch, Beats products, HomePod, iPod touch, and other Apple-branded and third-party accessories. Apple also makes revenue through services – digital content stores and streaming services, Apple Care, iCloud, and Licensing. The company operates various platforms, where customers can download applications and digital content, including books, music, video, games and podcasts. These platforms include the App Store, the TV App Store and the Watch App Store (Apple Inc., 2019, pp.1). Apple also offers subscription-based digital content streaming services, including Apple Music and Apple TV+ (Apple Inc., 2019, pp.1). iCloud is the company's cloud service, which stores music, photos, contacts, calendars, mail, documents and more, keeping them up-to-date and available across multiple Apple devices and Windows personal computers (Apple Inc., 2019, pp.1).

Unlike other enterprise-focused businesses, Apple sells its products mainly directly to consumers, small and mid-sized business, education, enterprise and government markets. The Company sells its products and resells third-party products in most of its major markets directly to consumers, small and mid-sized. Its distribution channels include physical retail stores, online stores, and a direct sales force which caters to larger orders. Apple also distributes its products through indirect distribution channels, such as third-party cellular network carriers, wholesalers, retailers and resellers. In 2018, indirect sales accounted for 69% of Apple's total sales, whereas direct sales accounted for 31% (Apple Inc., 2019, pp.2). No single customer made up more than 10% of Apple's total sales (Apple Inc., 2019, pp.2).

3c. Financial performance

Apple is known for its size and revenue. Its worldwide annual revenue consistently tops \$260 billion. In August 2018, Apple became the first public U.S. company to be valued at over \$1 trillion (Salinas, 2018). Apple has been experiencing strong financial performance in 2020. In the first fiscal quarter of financial year 2020, Apple reported a net income record of \$22.2 billion, and generated an operating cash flow of \$30.5 billion. In order to maintain its target of reaching a net cash neutral position over time, it also returned nearly \$25 billion to shareholders during the quarter, including \$20 billion in share repurchases and \$3.5 billion in dividends and equivalents. Apple projected ambitious financial targets for the fiscal 2020 second quarter (ends on April 30, 2020). It expects to reach a revenue between \$63.0 billion and \$67.0 billion,

a gross margin between 38.0 percent and 39.0 percent, operating expenses between \$9.6 billion and \$9.7 billion (Apple Press Release, 2020). However, given the recent decline in consumer spending, it remains to be seen whether Apple will be able to meet these targets. It is likely that it will fall short.

Products and services performance

Despite strong performance in the first quarter of fiscal year 2020, in 2019, total net sales decreased 2%, or \$5.4 billion, compared to 2018. This was partially caused by a decline in sales of the iPhone. Net sales for iPhone were down 14%, from \$165 billion in 2018 to \$142 billion in 2019. Sales of Macs increased by 2%, sales of the iPad increased by 16%. However, the decline in iPhone sales was offset by an increase in sales of Apple products including wearables and accessories (increased by 41%) such as the Apple Watch, as well as an increase in use of Apple services (increased by 16%) such as Apple Music and Apple TV+ (Apple Inc., 2019, pp.19).

Regional operating performance

The Company's reportable operating segments includes of the Americas (both North and South), Europe (includes Europe, India, the Middle East and Africa), Greater China (China, Hong Kong, and Taiwan), Japan and Rest of Asia Pacific. Apple's sales in the Americas makes up 45% of total sales. Sales in Europe account for 23%, sales in China account for 16.5%, Japan makes up 8.5%, while the rest of Asia Pacific accounts for 6.8% of total sales (Apple Inc., 2019, pp.20). In 2019, Apple's net sales in the Americas experienced a 4% increase, which is caused mainly by the increase in sales of wearables and home accessories, as well as Apple Services. Sales in Europe decreased by 3%, primarily due to lower iPhone sales, as well as a weakness in foreign currencies relative to the U.S. dollar which had a negative impact of European net sales. Greater China net sales decreased the most, by 16%, though this was also partially due to the weakness of the Chinese yuan compared to the U.S. dollar. Sales in Japan decreased by 1%, though the value of the Japanese Yen relative to the U.S. dollar have a positive impact on net sales. The Rest of Asia Pacific net sales increased by 2% primarily due to higher Wearables, Home and Accessories and Services net sales, partially offset by lower iPhone net sales (Apple Inc., 2019, pp.20).

3d. Risks and Threats

Shifting global economic conditions

Because of Apple's global reach and its extensive chain of international operations, (sales outside the U.S. representing a majority of its revenue, and a majority of its supply chain

is also located outside the U.S.), Apple is extremely susceptible to economic and geopolitical shifts on the global scale. According to Apple's 10-K annual report, "adverse macroeconomic conditions, including inflation, slower growth or recession, new or increased tariffs, changes to fiscal and monetary policy, tighter credit, higher interest rates, high unemployment and currency fluctuations" can all materially affect demand for Apple's products and services (Apple Inc., 2019, pp.5), damaging its financial conditions and growth. Thus, it is crucial that Apple diversify its international operations, so as not to be adversely disproportionately affected by regional macroeconomic and political changes.

In particular, Apple, like many other consumer technology companies, suffers from a problem of having a disproportionately large percentage of its manufacturing and supply chain operations in China. As of 2019, more than 90% of Apple's products are assembled in China (Li and Ting-Fang, 2019). Of Apple's 809 production facilities, over 350 are located in China, accounting for more than 43% of total production facilities. China also contains 41 out of 198 of Apple's total suppliers. Other top locations for production include the U.S., Japan, Taiwan, and South Korea. Aside from the U.S., all of Apple's top locations for production are located in East Asia, and therefore likely to suffer from the same macroeconomic/geopolitical shocks (Nikkei Asian Review Analysis, 2019). Therefore, Apple has a high invested interest in reducing the risk of relying heavily on a single place to manufacture its products.

Intellectual property

Intellectual property patents are an integral part of Apple's business model, as the company currently holds a large number of intellectual patents related to certain technological aspect of its hardware, software, accessories and services. Apple also regularly files patent applications around the world to protect innovations arising from its research, development and design. These patents, copyrights, trademarks, service marks are essential to Apple's core business because it prevents intellectual property theft by third-party manufacturers, allowing Apple to maintain the integrity and consistently high-quality of its products.

Apple has faced numerous intellectual property battles in the past, and has long faced the risk that doing business in overseas, where patent infringement laws are less strict, will compromise its intellectual property and trade secrets. Many competitors seek to emulate Apple's products at a lower price and quality, utilizing an aggressive pricing strategy and low-cost structures and infringing on Apple's intellectual property rights. In China, for example, intellectual property infringement is almost certainly damaging the company's business, due to Apple's large exposure to China's increasingly sophisticated manufacturing sector. In 2018,

for example, a former Apple engineer in China was arrested and charged with stealing self-driving car secrets. The engineer has denied such claims and pleaded not guilty in California court (Fazzini 2019). Therefore, it is critical that Apple is able to prevent intellectual property infringement in the country of expansion.

Rising global competition

The consumer electronics industry is a highly competitive global market characterized by aggressive price competition. As a result, there is continuous downward pressure on price and gross margins. Frequent introduction of new products and services means that companies must be constantly innovating and continually improving its price/performance characteristics, in order to remain relevant in the industry. Apple's continued success and dominance in the industry is dependent on its ability to ensure a constant and timely introduction of innovative new products, services and technologies to the market place. Therefore, Apple must make significant investments in R&D to develop new products and services that consumers find valuable or a significant improvement from its older products.

Given that Apple operates in the computer, smartphone and entertainment technology spaces, it faces competition from an ever-growing array of competitors. On the computer side, Apple's primary competitors are Dell Technologies, HP Inc., Lenovo Group, and Sony Corp. On the smartphone side, Apple faces competitions from Samsung, Xiaomi, Huawei and others. The market is increasingly segmented, as consumers benefit from expanded choice, innovation and lowered prices.

4. External Audit and Environmental Scan

4a. Rationale for Apple's expansion into Malaysia

Although it received less media attention and has experienced economic growth at a slower rate than its neighbours, the East Asian Tigers, Southeast Asia is one of the world's fastest growing economic regions in the world. After achieving political independence at various times from the early 1940s to 1950s, modern industry in oil, automobile parts, hi-tech goods, and telecoms began to flourish, leading to growth in the regional economy. Today, Southeast Asia is one of the most dynamic economic regions in the world, with a combination of emerging and developed economies, making it an important driver of global economic growth. Many of the ten ASEAN nations have enjoyed average annual growth rates in excess of 5 percent in recent years. Developed countries such as Singapore are great potential markets

for Apple's products, whereas emerging developing economies such as Malaysia would be prime location for Apple to shift their production capacities. Therefore, we believe that Southeast Asian is the prime location for Apple to expand its existing retail and manufacturing business. However, for the purposes of this report, we will be focusing on Malaysia in particular. This is because we believe that Malaysia's high GDP per capita as well as high GDP growth makes it the optimal country for Apple to expand both its supply chain and manufacturing operations, as well as find new markets and consumers for its products and services.

According to the International Monetary Fund's World Economic Outlook Database, five of the top ten countries in terms of projected GDP growth in 2020 were in Southeast Asia. Bangladesh, Vietnam and the Philippines were ranked as the top three countries for GDP growth in 2020, while Malaysia came in eighth in the world, with a projected GDP growth rate of 4.40% (International Monetary Fund, 2019). Malaysia is also ranked third in the Southeast Asian region in terms of nominal GDP per capital, with a nominal GDP per capital of \$11,136, which is roughly 44.5% higher than that of the next richest Southeast Asia countries, Thailand, at \$7,791 per capita (International Monetary Fund, 2019). Thus, Malaysia's comparatively wealthy population, as well as a growing middle class due to the high projected growth rate of its economy, means that more of its population will be able to afford to purchase Apple's products, as well as providing labour for Apple's supply chain and manufacturing process. In the next few sections, we will be providing an overview of the micro and macro business environment in Malaysia in order to provide the basis for policy recommendations for Apple's expansion of sales and operations into the country.

4b. Business environment in Malaysia

Malaysia has a newly industrialized market economy, with significant state-intervention. It is also one of the fastest growing economies in the Southeast Asia, and is rapidly approaching its target of becoming a developed economy. "Although the Malaysian economy has historically heavily relied on agriculture, the sector now contributes only 7.1% to the country's the GDP. Industry accounts for 36.8% of the national GDP, while the services sector is the biggest contributor, accounting for 56.2% of national GDP" (Sen Nag, 2019). Malaysia's economy has been on an upward trajectory, averaging growth of 5.4 percent since 2010, and is expected to achieve its transition from an upper middle-income economy to a high-income economy by 2024 (World Bank, 2019).

The government of Malaysia has outlined its Vision 2020, which aims to make Malaysia a high-income country by 2020 through an ambitious economic modernization plan. This plan includes shifting the economy away from its traditional reliance on natural resources industry towards higher value-added industries and services. Provided that the government's efforts are successful, this will enhance the business environment in Malaysia and consolidate its position as an economic pillar of Southeast Asia by playing upon the country's major advantages: a population with high proficiency in English and a regulatory and fiscal environment with relatively low taxes, designed to foster competition and foreign investment. Furthermore, Malaysia's growing middle class will soon become a very attractive customer base for business. Local and foreign companies should seize the opportunity to capture a part of the solvable and sizable Malaysian market. Local authorities have also engaged in a movement towards making its development sustainable, fostering greener cities with more public transportation and environmental initiatives.

Labour supply

Malaysia has touted its 12 million strong workforce as a highly skilled labour pool, making it a prime location able to provide a competitive advantage of businesses setting up in the area. In February 2020, the government enacted a minimum wage at RM1,200 (US \$283) per month, while the rate for employees earning an hourly rate has been increased to RM 5.77 (US \$1.36) from RM 5.29 in 2019. This is part of the drive of the government to upskill and modernize the country's workforce (Medina, 2020). The minimum wage increase will be available in 56 cities and municipality councils (Medina, 2020). However, even with the increase, Malaysia still offers an attractive business environment, as its minimum wage is still roughly equivalent with the regions with the lowest level of minimum wage in China, Heilongjiang, whereas more industrialized and modernized areas of China, such as Beijing, have a minimum wage as high as 25 RMB (3.53 USD) per hour.

However, due to a rapidly growing economy, Malaysia is to potentially see a rise in minimum wages across the region as businesses face increasingly higher costs of production. While nations such as Myanmar, Cambodia and Vietnam may be less developed infrastructure and support services for industrial activity, an increase in the minimum wage in Malaysia could lead to a loss of foreign business in favour of these countries with lower production costs. However, if the minimum wage stays stable, higher real wages in Malaysia will also lead to an uptick in private consumption over the medium-to-long term, making it good long-term investment for Apple to establish a foothold in the market

Policy considerations

Malaysia's government has implemented changes to improve the business environment and that has brought the country to its 29th ranking on the 2016 Index of Economic Freedom. According to the index Malaysia has seen improvements in the areas of rule of law, market freedom, government spending and regulatory from the previous year. Recurrent business expenditure and overheads are low comparatively to other emerging markets, resulting in Malaysia becoming one of the low-cost alternatives to run businesses in the Southeast Asia region. Additionally, there are government incentives offered by MIDA, the official government organization in charge of trade and investment promotions, in the form of tax incentives and loans/grants to businesses.

Foreign businesses can be found in most sectors of the economy as restrictions are low. Malaysia's multi-lingual workforce is also advantageous to foreign business setup. In the Global Competitiveness Index by The World Economic Forum Malaysia ranks as 25th out of 138 countries, scoring highly in indicators such as institutions, infrastructure, macroeconomic environment and health and primary education, constituting to a stable and sustainable business environment. Chambers of commerce in Malaysia are also specifically designed to facilitate the expansion of foreign business' operations.

4c. Governance, institutions and corruption

The Southeast Asian countries have relatively stable political institutions. Recent years have seen a rise in "stabilitocracies" – countries that are growing economically, providing lucrative markets for western countries. Malaysia is one of these countries, as the country operates under the framework of a federal representative democratic constitutional monarchy, where Yang di-Pertuan Agong is the head of state and the Prime Minister of Malaysia is the head of government. Malaysian politics had been relatively stable in recent years. Malaysia was ranked 24th in the world in the 2020 Economic Freedom Index, with an economic freedom score of 74.7 (Heritage.org, 2020). In recent years, the government has made positive moves to curb corruption and consolidate public debt, which, if successful, would enhance economic freedom. Former Prime Minister Najib Razak was prosecuted on charges of orchestrating a multibillion-dollar fraud involving a government fund, representing a step in the right direction. According to the 2020 Economic Freedom Index, Malaysian law affords strong protections for private property, as well as intellectual property, as Malaysia's legal system generally reflects English common law. Malaysia also ranks highly for regulatory efficiency and judicial independent.

4d. Risks and considerations

First, although Malaysia's economic and political environment are both favourable for Apple to deepen its foothold into the market, Malaysia's relatively small market size compared to other regions such as China means limited benefits from expansion. It has a population of 31.53 million (World Bank, 2020), which is only about one tenth of the population of the United States, and 2% of China's population. Second, complications arising from the coronavirus may pose a threat to economic growth and also cause an increase in political turmoil. The central bank has projected that the economy could shrink in the year 2020 as a result of the coronavirus by as much as 2%, constituting its worst economic performance in more than a decade (Latiff, 2020). However, this is a global problem, and not limited to Malaysia's economy.

4e. Opportunities

Southeast Asia is one of the few parts of the world where smartphone sales continue to grow at a double-digit percentage. With its devices accounting for a minor share of the region's markets, primarily due to pricing and a lack of carrier subsidies, Apple has great potential to develop a lucrative business in Malaysia if it steps up its retail focus. The second highest connectivity in region behind Singapore, Malaysia has a much larger population which makes it one of the best market potentials for growth in Southeast Asia. These characteristics help to accelerate the development of online and technological business.

With 'Cloud First' strategy, promoting cloud adoptions for public and private sectors, and the Digital Free Trade Zone (DFTZ) initiative, jointly created by Alibaba Group and the Malaysia Digital Economy Corporation, Malaysia's digital economy is on course to contribute over 20% of the country's GDP in 2020. Under the government's sustained efforts in 'digital transformations', the demand for digital products and consumer electronics is set to continue to rise.

5. Porter's Five Forces Analysis

With the above information Porter's Five Forces model will be applied to determine Apple's current position in the industry structure and explore effective strategies for further growth and expansion.

5a. Bargaining Power of Suppliers

Apple maintains control over its suppliers by managing a complex chain of suppliers whereby product parts are developed separately by suppliers from different regions, i.e. One part may be developed by a supplier in Taiwan, another by a Japanese supplier, with the final assembly done in China. As such, switching cost of suppliers would be low and would increase the company's bargaining position against its current suppliers.

5b. Bargaining Power of Customers

With centralizing innovation in one physical location, the 'Design in California' approach helps cultivate a loyal following. Apple's effective and rapid innovation process by internal R&D investments and acquisitions of new tech companies helps sustain Apple's competitive advantage. With the threat of losing market share to emerging competitors such as Huawei, bargaining power of customers could be considered as rising from low to moderate.

5c. Threat of New Entrants

Since the cost for new entrants in the technological sphere is high, this threat is relatively low. Even existing tech companies can diversify into smart phone and mobile device market, such as Amazon with its Kindle and Fire smartphone, main threat remains to be coming from existing players. As such, I argue that maintaining Apple's high value and innovative brand image and Apple's 'closed' ecosystem are essential strategies to protect itself from the threats of other brands.

5d. Threat of Substitutes

As Apple's pricing and product development strategies have been focusing on premium devices selling for high prices, competitors such as Samsung, Xiaomi and Huawei have been taking advantage to increase the mobile device market share by introducing low and mid-price models with similar functionalities and designs. Hence, this threat is moderate and will continue to grow, in particular outside the US where brand loyalty is comparatively weaker.

5e. Competitive Rivalry between existing players

The level of competitive rivalry is strong in the technological industry. In particular with the rise of Huawei, its high profile strategic partnership with Leica, vast investments in R&D in both mobile devices and infrastructures such as 5G, not only is Huawei introducing products of quality but also raising its industry position, brand image and recognition drastically.