

Who Wants A Hand Job?

By Paul Quigley

In classical mythology, and in many religions, death marks the end of one phase and the glorious rebirth into another, better stage of enlightenment.

How so then do the pundits accuse Ericsson's timely exit from bolting handsets together as some sort of exercise in industrial death on the vine?

There is a world of difference between pulling out of mobile phone production and pulling out of mobile phones. Unfortunately, the stock markets only tend to read half the sentence. This time yet again they get it wrong. Ericsson's decision to do little more than change the name of its handset assembly and fabrication division to 'Flextronics Inc.' and spare itself a whole gamut of risk, has been misinterpreted as some kind of fast exit from the industry entirely.

In the same breath, Ericsson states categorically that it remains one hundred percent involved in all aspects of wireless handsets, only the producer operation goes outside the four walls of Ericsson Inc. Kurt Hellstrom, Ericsson's tough CEO knows only too well that now is not the time to desert handsets. Given that the success and or failure of post-second generation cellular rises or falls on the acceptance by hundreds of millions of users on the sexiness and facilitation of handsets, Hellstrom may as well sign up as the new England football manager alongside 'Sven Goran Nokia'.

In turbulent times such as these we are entering, that's just what market makers and shareholders need to see. In the midst of what Hellstrom calls Ericsson's "Back To Profits" campaign, many analysts are baying that Ericsson should even bail out of handsets completely. You get what you pay for.

But jabbing at the handset players this way is part of the 'bully's argument' - because everyone else is doing it. However, Ericsson has actually been outsourcing for the last two years. The only difference between then and now is that they didn't make a big hoopla about doing it before. The Ericsson 'predicament' is as much about companies like Flextronics being able to take the strain in an area where they excel. The EMS sector - Electronics Manufacturing Services - of which Mark's Flextronics is arguably the market leader, can manage inventories and do the whole production run faster and cheaper than the companies like Ericsson, Motorola and probably even Nokia.

The precedents before Ericsson's handset deal with Flextronics are already there for all to see: Marconi partnering with Jabil Circuits, Siemens with Flextronics, Motorola with Flextronics, Nortel Networks with SCI Systems - the list will go on and on as the EMS sector bails out the cellular handset players. Furthermore, the move towards the 'front end' of the production cycle can be seen by a shift from OEM to 'original design manufacturing' - ODM - arrangements. Some manufacturers are also moving to the

'back end' of the cycle by getting hands-on involved in the development of brand name products too.

The only thing that's surprising about Ericsson's outsourcing deal to Flextronics is that it took so long. It shouldn't be long before companies are queuing up at the door of contract manufacturers like Flextronics. After all, it's been de rigeur for years in the computer assembly business to offload the nuts and bolts business so that the original equipment manufacturer can focus on their real core competencies. Funny how the trend swings to and fro each decade and a half. Once it was cool and desirable, indeed expected, to have that old friend - vertical integration - ownership of the entire value chain - in-house. How things have shuddered to a halt and done an abrupt U-turn in the new climate. It's not good to be too over-exposed anymore. It's better to share the risk burden.

In topsy-turvy times, fund managers are tending to stick with contract manufacturers like Flextronics and others. These operations all have enormous multi-billion ongoing contracts to lean on with huge OEMs such as Ericsson. What's more, contract manufacturers and ODMs like these have the biggest margins going these days. Their fab plants are conveyer belts on acid. The plants of Ericsson and others look like 1920s Ford Model T lines. The PCB and plastic economies they can get pee all over the mobile industries too. It's a smart call and anyone who sees this move as bad probably thinks WAP is easy to use too.

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