

Mobile Devices Spotlight

Apple Phone: Who Cares? (And Why)

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Apple's strict pre-launch secrecy has helped fuel rampant speculation among the financial analyst community and press that Apple will launch a phone next week at MacWorld as a defensive move to protect its iPod franchise. Of course, when it's a secret, it can be all things to all people, so Apple risks a backlash if it doesn't release a revolutionary product, or doesn't announce anything at all.

Here at Current Analysis, we focus on the current competitive environment, not speculating about "what if..." We do not claim to know what products Apple is working on, when they will be available, or how they will be distributed. On the other hand, we've gotten the question so often that it's time to answer, "what might an Apple phone mean for the industry?"

What Would an Apple Phone Mean for the Industry?

User Interface

The primary threat to existing vendors is in the user interface. If Apple builds a phone that is easy and genuinely pleasurable to use, the company will have a winner no matter how it is priced or sold. Why hasn't anyone designed a bar phone with a slide lock/unlock switch found on every iPod (other than the shuffle) since its launch? It's not that Apple has a lock – forgive the pun – on good ideas; Palm and RIM do include a dedicated slider/button for silencing the phone, and Nokia has a wonderful mini-menu for invoking frequently used features. Unfortunately, Nokia then puts the menu in the absolute worst possible location: under the on/off switch (press quickly, the menu pops up - press and hold, and the phone turns off), where no one



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could possibly discover it. SEND and END keys are the equivalent of a steering wheel on a car, but Sony Ericsson and Nokia don't label their SEND and END keys anymore – on Sony Ericsson phones, they actually double as menu selection buttons. Even an unlabeled button might work if it gets specially lit up when appropriate (like when the phone is ringing) so users aren't left to guess which button to press to accept the call.

A Complete Music Solution

Even if Apple does not announce a phone, just the threat of Apple's entry could spur innovation in terms of the music value proposition. There are plenty of phones that play music, but very few true musicphones. Most make you work to synchronize it from your PC, most have terrible user interfaces, and even the dedicated media control keys (on the phones that actually have them) only work when you're in "music" mode, making background listening a chore. Sony Ericsson's Walkman line gets closest to the ideal, and has been rewarded with record sales. So there's definitely a market for a converged music phone done right.

Apple also doesn't release half products; an iPod comes with everything you need to listen to music. This is not the case in the cell phone industry, where even phones promoted as flagship music devices, like Samsung's SYNC at Cingular, lack the basics like headphones or enough memory to do anything useful. Verizon Wireless sells a \$30 Music Essentials Kit for its musicphones that provides headphones, a data synchronization cable and PC synchronization software. Quick note to Verizon Wireless: if they are essentials, they should be included. Yet even the Essentials Kit isn't complete – a microSD memory card is still another extra.



Battery life is another area ripe for fresh approaches. This isn't like the iPod where Apple essentially cornered the market on new storage technologies (first with the 1.8" hard disk drive, more recently with large amounts of flash memory); there isn't any commercially available battery technology that Nokia, Motorola etc. don't know about. But even Samsung's defeatist approach with the BlackJack – it includes two batteries and a nifty dual charger – is better than ignoring the problem altogether. Even a converged phone must always be a phone; if the battery runs down while playing songs or videos, it is no longer a phone. Apple could include a second, just-for-voice battery, or achieve the same effect in software ("Hello. Your music has been paused. If you continue playing music, you will have less than an hour of talk time left.").

Physical Design

Apple is known for building gorgeous hardware with incredible attention to detail. Therefore, conventional wisdom suggests that an Apple phone could have a significant impact on phone design. Conventional wisdom is wrong: handset vendors actually have very little to worry about in this respect. Yes, Apple makes beautiful devices – compared to Dell. But cellphone

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manufacturers are no slouches in this department. If you are a designer at Nokia, you aren't worried about a super-thin bar phone from Apple, you're looking at Motorola's MOTOFOUR and wondering when consumers are going to get tired of the RAZR. Apple's nano blew people away with how thin it is, but nobody is going to build something dramatically thinner than Samsung's Ultra line anytime soon.

With "thin" now an expected characteristic of any phone on the market, handset vendors are already trying to stand out by using colors, materials and finishes (CMF). Motorola, LG and Nokia already use advanced CMF on their premium lines. Apple does have experience in this area, too, but doing CMF well on a phone is not trivial. Not only do some metal cases interact badly with internal antennas, even certain paint colors interfere with cell phone reception.



Mobile OS

Speculating about a smartphone from Apple is fun – the possibilities are endless. Would Apple go with an established mobile OS like Symbian or Windows Mobile? History suggests Apple would prefer more control even at the cost of time to market, but you never know. OS X is based on BSD UNIX and Apple is comfortable with the open source model, so why not build a mobile OS on UNIX or Linux? An Apple flavor of mobile Linux could provide an alternative to the Motorola/Samsung consortium standard. There are even pre-built platforms (e.g., from TrollTech) for Apple to build on, similar to the way it built the iPod on firmware from Portal Player. Regardless, Apple certainly knows how to attract software developers to underdog platforms, so nearly any type of smartphone from Apple would be a threat to the established order.

Pricing and Distribution

It's not too difficult to imagine what an Apple phone might look like. It's considerably harder to pick the right business model getting a phone to market. There are a number of structural constraints to consider:

- U.S. carriers use different wireless network technologies, and many consumers have definite carrier preferences. In other words, if an Apple phone is only available on, say, Cingular, and you are a Verizon Wireless customer because of coverage reasons or because that is the preferred vendor for your company, you can't buy the iPhone at all.
- It's damned complicated to support more than one U.S. carrier. Just to supply the top three carriers, vendors need to support different combinations of core technologies. For example, Cingular's network/runtime environment is GSM/Java, Verizon Wireless is CDMA/BREW and Sprint is CDMA/Java. The combinations get much, much more complicated when you throw in carrier-specific user interfaces, messaging clients, email clients, Web

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browsers, a GPS, PTT and DRM.

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- The market dynamics have shifted rapidly over the last 18 months. Phones that should sell for \$400 unlocked are being subsidized down to \$49 with a contract. The Samsung SYNC has quadband EDGE and HSDPA, a QVGA screen, a 2 MP camera, removable memory, an MP3 player with dedicated media control keys and is packed into a thin clamshell case. Cingular is selling it for \$49. Even once you factor in the cost of headphones and memory, that's going to be tough to beat.
- Unlike iPods or PCs, many consumers are locked into contracts with their phones, and can't buy a new model right away.

The service plans at most carriers and MVNOs are unbelievably complicated, especially once you start talking about data, and Apple has a history of simplifying pricing plans (\$0.99 downloads, no subscriptions, no variable rates, no bundles, just \$0.99 each. Got it?). If Apple chooses the MVNO route (or some sort of hybrid, where the carrier offers Apple-specific plans) that is another area where it could stand out. But even here, an MVNO is not an easy business to run. Margins are low, and customer service is expensive. Apple cannot charge the same \$0.99 per song an iTunes user pays for the same song downloaded over the air – the airtime costs money.

If Apple does try anything other than carrier-store distribution, it will be a boon to brand-centric handset vendors like who have been frustrated by the carriers' control of the customer. U.S. consumers don't know that they could buy a phone somewhere else, and if Apple educates the market, Nokia and Sony Ericsson would be quite grateful.

WiFi

A WiFi-only VoIP "phone" would get Apple around the GSM vs. CDMA and global frequency selection problems, but would not be a direct competitor to cellphones. An Apple WiFi voice device would initially be considered a competitor to the two WiFi VoIP products already on the market: Nokia's 770 and Sony's mylo. Neither are complete products today – the 770 is the wrong form factor for voice, and the mylo's features are half-baked. Apple's entry would legitimize the category, which hardly exists today, but wouldn't be an effective strategic move to counter musicphones.

Conclusion

Even if Apple is not building a phone, just the threat of one could spur better user interface development and musicphone value propositions. But the fragmented nature of the market – and carrier-controlled distribution – means that even a spectacular new product can have only a limited initial sales impact. Assuming that my flight out of Las Vegas from CES leaves and lands on time, I will be at MacWorld in San Francisco next week to see whatever Steve Jobs launches. Until then, please don't ask me if Apple is launching a phone!

This Spotlight is based on the report, "Apple Phone: Who Cares? (And Why)" published December 28, 2006. The complete report contains a section on the reasons behind Apple speculation and recommendations for handset vendors.