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Ex. 18



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Why the Apple phone will fail, and fail badly It's the Pippin all over again

By **Bill Ray**

Posted in [Mobile](#), [23rd December 2006 05:02 GMT](#)

Comment The hype is reaching fever-pitch, and the odds are still stacked that Apple will announce a device combining the functionality of an iPod and a mobile phone in January next year, but whether such a device will actually sell is another question.

There seems little question that an Apple phone product will be launched in 2007, and that it will work with the iTunes service and have a very pretty industrial design and a smooth interface. Strapping an iPod to a mobile phone is not a great technical challenge, which makes it all the more remarkable that Motorola did it so badly with their ROKR handset. Maintaining the features which made the iPod so popular in a mobile phone will be much more of a challenge.

The iPod brought with it amazing industrial design, a well designed interface, and a new usage paradigm. Portable music players already existed, but the iPod was better looking and easier to use. It also came with the promise that you didn't just carry music with you, you carried *all* your music with you. That factor alone changed the way portable music was perceived, and was central to the adoption of the iPod.

The iPod has moved away from that paradigm, with the Nano and Shuffle only able to store the most diminutive music collection, and recent rumours suggest that an Apple phone will have 8GB of flash-based storage; comparable with the Nano. But it was that function which sold the concept to many people, with the style and simplicity of use keeping them hooked.

It is important not to underestimate the importance of the iPod industrial design, or its scope. I recently had to sit in a pub as two iPod fans reminisced about feelings when opening their first iPod box, and their overwhelming admiration not for the product, but for the box in which it came. It was sickening, but demonstrated the loyalty iPod fans feel, and the expectations that will need to be met.

The clever design of the iPod stretched into the software - the clean and simple interface is indeed easy to use, and users seem very comfortable with iTunes on their PC. But creating a simple interface for a single function is one thing. Replicating that experience to manage all the functions of a mobile phone is another thing entirely.

Mobile phones are not complex to use because of bad interface design, they are complex to use because they are complex devices with a myriad of features. The

fiercely competitive mobile phone business has driven interface development at an astounding rate: it has become de rigueur for every new handset to feature a revolutionary new interface mechanism.

Apple is extremely good at creating simple interfaces, and it is likely that the Apple phone will have a pleasing interface which is relatively easy to use and recognisably iPod branded, but it won't need to appeal to the iPod users, it will need to appeal to the network operators.

Who buys mobile phones?

When a manufacturer launches a new mobile phone handset they take the specification, or prototypes, round to the network operators and try to convince them that this phone will be the next big thing. In most markets mobile phones are sold to customers with an enormous subsidy provided by the network operator, who intends to make the money back through additional service use.

The operator will have a list of features they like and will compare that list to the newly-developed phone to calculate the subsidy: a camera might be worth a fiver, while a one-touch-to-send-MMS button could be worth £20. The idea is that easier access to more premium features leads to greater revenue, and thus pays off the subsidy.

In this way a phone that might cost hundreds of pounds can be given away for free, depending on the tariff, and the industry is sustained by customers paying off the cost of their handset over several years.

It's not just features which contribute to the negotiated subsidy. Big advertising by the manufacturers also contributes as networks want to offer popular handsets at low prices, particularly in markets where network choice is often decided by handset availability and price.

Exclusivity will also enhance the subsidy - as little as a month's exclusivity on a handset will massively increase the subsidy, and the amount the network operator will spend promoting deals involving the handset. Few manufacturers will agree to this, but some can be convinced.

Mobile phone manufacturers know this, and have copies of the network operators' features lists, as well as a clear idea of what kind of deals are available. The industry is competitive, but tightly organised and pretty incestuous as staff move between operator, manufacturer, and supplier while maintaining their contacts and golfing partners.

Who will pay for the Apple phone?

A new player coming into the market is either going to have to offer the phone unsubsidised, at its true retail cost, subsidise it itself, or find a way to convince network operators they can gain from subsidising the handset.

A few companies have tried to offer phones without subsidy; relying on stylish design and branding to off-set the high cost and lack of features. Most notable was Xelibri, a

range of good-looking phones which Siemens tried to sell direct to the public before giving up in 2004. It is possible for very high end handsets such as the [Vertu \[1\]](#) range from Nokia, but when your handsets start at \$4,500 a couple of hundred quid subsidy is neither here nor there.

The Apple phone will be able to charge a premium for style, but put a £330 iPod phone on the shelf next to a Sony Walkman handset with similar capabilities which is free and it will be a tough sell for anyone.

Some have suggested that Apple will simply set up their own Mobile Virtual Network Operator (MVNO) and just fund the subsidy; making the money back on calls and use of the iTunes service. However, iTunes has always existed to sell hardware, not subsidise its production. The service isn't supposed to make money, and while it might or might not lose a great deal of money it certainly can't be called upon to cover the cost of a stylish handset any more than it could cover the cost of handing out iPods for free.

So we are left with Apple trying to sell its phone to existing network operators using the same tactics as its competitors. It might make play of its simple interface, and easy access to operator services, but far more likely Apple will use network exclusivity to sell the idea to a single operator in each territory.

The iPod is now a valuable brand, and one associated with the youth market operators are so keen to attract. This alone could make the Apple phone attractive, especially if only one operator has such an association.

By limiting the distribution of the handset in this way Apple will be spared the need to negotiate with dozens of different operators, and can share the promotional costs with the operator of choice - who will be hoping customers will switch networks just to get one. Such a deal would reduce the number of handsets Apple would be able to sell, but that might be no bad thing as it would reduce Apple's exposure while (hopefully) demonstrating its ability in the market.

But it would also make Apple dependent on that operator, and on that operator's commitment to the project; particularly when the first flush of publicity is past.

It's business, not pleasure

Apple will launch a mobile phone in January, and it will become available during 2007. It will be a lovely bit of kit, a pleasure to behold, and its limited functionality will be easy to access and use.

The Apple phone will be exclusive to one of the major networks in each territory and some customers will switch networks just to get it, but not as many as had been hoped.

As customers start to realise that the competition offers better functionality at a lower price, by negotiating a better subsidy, sales will stagnate. After a year a new version will be launched, but it will lack the innovation of the first and quickly vanish.

The only question remaining is if, when the iPod phone fails, it will take the iPod with it. ®

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1. <http://www.vertu.com/homepage.jsp?lang=en>

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[Apple said to have 3G-enabled iPod in pipeline](http://www.reghardware.com/2011/07/11/ipod_touch_to_get_3g/) (11 July 2011)

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Bloomberg

Apple iPhone Will Fail in a Late, Defensive Move: Matthew Lynn

Commentary by Matthew Lynn - Jan 14, 2007

Jan. 15 (Bloomberg) -- Few products have been launched with such a blizzard of publicity as [Apple Inc.](#)'s iPhone.

To its many fans, Apple is more of a religious cult than a company. An iToaster that downloads music while toasting bread would probably get the same kind of worldwide attention.

Don't let that fool you into thinking that it matters. The big competitors in the mobile-phone industry such as [Nokia Oy](#) and [Motorola Inc.](#) won't be whispering nervously into their clamshells over a new threat to their business.

The iPhone is nothing more than a luxury bauble that will appeal to a few gadget freaks. In terms of its impact on the industry, the iPhone is less relevant.

If column inches and airtime guaranteed commercial success, Apple would already have a global hit on its hands. For the past week, it has been impossible to open a newspaper or look at a Web site without reading something about the shiny new phone.

Certainly, it looks like a nice piece of equipment. The iPhone combines Apple's iPod music and video player with a mobile phone as well as having wireless Internet access for e-mail. Instead of lugging around a phone for making calls, an MP3 player for listening to music, and a Blackberry for checking your e-mail, you can do all three on one device. Even better, you only need one charger.

It will be released in the U.S. in June, with a rollout to the rest of the world later, and will cost \$499 to \$599, depending on how much storage space you want. How many might they sell? Ten million in 2008, according to Apple Chief Executive Officer [Steve Jobs](#).

Three Reasons

Not everyone is sold on the idea.

“The iPhone will not substantially alter the fundamental structure and challenges of the mobile industry,” [Charles Golvin](#), an analyst at Forrester Research Inc., said in a report this month.

There are three reasons that Apple is unlikely to make much of an impact on this market -- and why it is too early to start dumping your Nokia [shares](#).

First, Apple is late to this party. The company didn't invent the personal computer or MP3 player, but it was among the pioneers of both products. Yet there is no shortage of phones out there. There are already big companies that dominate the space, all of whom will defend their turf. That means Apple will have to fight hard for every [sale](#).

Next, the mobile-phone industry depends on cooperation with the big networks. Phones -- the high-end ones in particular -- are usually sold with a network contract. The provider subsidizes the handset in the U.K. and hopes to recoup its money with ridiculously expensive charges for calls and data. Yet Apple has never been good at working with other companies. If it knew how to do that, it would be Microsoft Corp.

Network Opposition

On top of that, its rivals will be pulling out all the stops to prevent the networks offering iPhones. Sure, a big operator such as [Vodafone Group Plc](#) would like an exclusive deal to sell the iPhone in, say, the U.K. market. Against that, how much does it want to annoy Nokia -- and what kind of incentives will Nokia be offering not to go with the Apple product? There will be lots of tough conversations between companies that know each other well. Apple will find it hard to win those negotiations.

Lastly, the iPhone is a defensive product. It is mainly designed to protect the iPod, which is coming under attack from mobile manufacturers adding music players to their handsets. Yet defensive products don't usually work -- consumers are interested in new things, not reheated versions of old things. Likewise, who is it pitched at? The price and the e-mail features make it look like a business product. But Apple is a consumer company. Will your accounts department stump up for a fancy new handset just so you can listen to [Eminem](#) on your way to a business meeting?

Fresh Competition

In many ways, that is a shame. The mobile-phone industry is becoming a cozy cartel between the network operators and a limited range of manufacturers. It could certainly use a fresh blast of competition from an industry outsider.

It may come -- but probably from an entrepreneurial start-up somewhere. How about phones with fewer gadgets but better at making calls? Or with never-ending batteries? Or chargers that don't weigh three times as much as the phone?

It won't come from the iPhone. Apple will sell a few to its fans, but the iPhone won't make a long-term mark on the industry.

([Matthew Lynn](#) is a Bloomberg News columnist. The opinions expressed are his own.)

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