

Case study

Apple's profitable but risky strategy

When Apple's Chief Executive – Steven Jobs – launched the Apple iPod in 2001 and the iPhone in 2007, he made a significant shift in the company's strategy from the relatively safe market of innovative, premium-priced computers into the highly competitive markets of consumer electronics. This case explores this profitable but risky strategy.

Note that this case explores in 2008 *before* Nokia had major problems with smartphones – see Case 9.2 and Case 15.1 for this later situation.

Early beginnings

To understand any company's strategy, it is helpful to begin by looking back at its roots. Founded in 1976, Apple built its early reputation on innovative personal computers that were particularly easy for customers to use and as a result were priced higher than those of competitors. The inspiration for this strategy came from a visit by the founders of the company – Steven Jobs and Steven Wozniack – to the Palo Alto research laboratories of the Xerox Corporation in 1979. They observed that Xerox had developed an early version of a computer interface screen with the drop-down menus that are widely used today on all personal computers. Most computers in the late 1970s still used complicated technical interfaces for even simple tasks like typing – still called 'word-processing' at the time.

Jobs and Wozniack took the concept back to Apple and developed their own computer – the Apple Macintosh (Mac) – that used this consumer-friendly interface. The Macintosh was launched in 1984. However, Apple did not sell to, or share the software with, rival companies. Over the next few years, this non-co-operation strategy turned out to be a major weakness for Apple.

Battle with Microsoft

Although the Mac had some initial success, its software was threatened by the introduction of Windows 1.0 from the rival company Microsoft, whose chief executive was the well-known Bill Gates. Microsoft's strategy was to make this software widely available to other computer manufacturers for a licence fee – quite unlike Apple. A legal dispute arose between Apple and Microsoft because Windows had many on-screen similarities to the Apple product. Eventually, Microsoft signed an agreement with Apple saying that it would not use Mac technology in

Windows 1.0. Microsoft retained the right to develop its own interface software similar to the original Xerox concept.

Coupled with Microsoft's willingness to distribute Windows freely to computer manufacturers, the legal agreement allowed Microsoft to develop alternative technology that had the same on-screen result. The result is history. By 1990, Microsoft had developed and distributed a version of Windows that would run on virtually all IBM-compatible personal computers – see Case 1.2. Apple's strategy of keeping its software exclusive was a major strategic mistake. The company was determined to avoid the same error when it came to the launch of the iPod and, in a more subtle way, with the later introduction of the iPhone.

Apple's innovative products

Unlike Microsoft with its focus on a software-only strategy, Apple remained a full-line computer manufacturer from that time, supplying both the hardware and the software. Apple continued to develop various innovative computers and related products. Early successes included the Mac2 and PowerBooks along with the world's first desktop publishing programme – PageMaker. This latter remains today the leading programme of its kind. It is widely used around the world in publishing and fashion houses. It remains exclusive to Apple and means that the company has a specialist market where it has real competitive advantage and can charge higher prices.

Not all Apple's new products were successful – the Newton personal digital assistant did not sell well. Apple's high price policy for its products and difficulties in manufacturing also meant that innovative products like the iBook had trouble competing in the personal computer market place.

Apple's move into consumer electronics

Around the year 2000, Apple identified a new strategic management opportunity to exploit the growing worldwide market in personal electronic devices – CD players, MP3 music players, digital cameras, etc. It would launch its own Apple versions of these products to add high-value, user-friendly software. Resulting products included iMovie for digital cameras and iDVD for DVD-players. But the product that really took off was the iPod – the personal music player that stored hundreds of CDs. And unlike the launch of its first personal computer, Apple sought industry co-operation rather than keeping the product to itself.

Launched in late 2001, the iPod was followed by the iTunes Music Store in 2003 in the USA and 2004 in Europe – the Music Store being a most important and innovatory

development. iTunes was essentially an agreement with the world's five leading record companies to allow legal downloading of music tracks using the internet for 99 cents each. This was a major coup for Apple – it had persuaded the record companies to adopt a different approach to the problem of music piracy. At the time, this revolutionary agreement was unique to Apple and was due to the negotiating skills of Steve Jobs, the Apple chief executive, and his network of contacts in the industry. This strategy paid off and the iPod became the biggest single sales contributor in the Apple portfolio of products.

In 2007, Apple followed up the launch of the iPod with the iPhone, a mobile telephone that had the same user-friendly design characteristics as its music machine. To make the iPhone widely available and, at the same time, to keep control, Apple entered into an exclusive contract with only one national mobile telephone carrier in each major country – for example, AT&T in the USA and O₂ in the UK. Its mobile phone was premium priced – for example, US\$599 in North America. However, in order to hit its volume targets, Apple later reduced its phone prices, though they still remained at the high end of the market. This was consistent with Apple's long-term, high-price, high-quality strategy. But the company was moving into the massive and still-expanding global mobile telephone market where competition had been fierce for many years.

And the leader in mobile telephones – Finland's Nokia – was about to hit back at Apple, though with mixed results. But other companies, notably the Korean company Samsung and the Taiwanese company, HTC, were to have more success later.

So, why was the Apple strategy risky?

By 2007, Apple's music player – the iPod – was the premium-priced, stylish market leader with around 60 per cent of world sales and the largest single contributor to Apple's turnover. Its iTunes download software had been re-developed to allow it to work with all Windows-compatible computers (about 90 per cent of all PCs) and it had around 75 per cent of the world music download market, the market being worth around US\$1000 million per annum. Although this was only some 6 per cent of the total recorded music market, it was growing fast. The rest of the market consisted of sales of CDs and DVDs direct from the leading recording companies.

In 2007, Apple's mobile telephone – the iPhone – had only just been launched. The sales objective was to sell 10 million phones in the first year: this needed to be compared with the annual mobile sales of the global market leader, Nokia, of around 350 million handsets. However, Apple had achieved what some commentators regarded as a significant technical breakthrough: the touch screen. This made the iPhone different in that its screen was no longer limited by the fixed buttons and small screens that applied to competitive handsets. As readers

will be aware, the iPhone went on to beat these earlier sales estimates and was followed by a new design, the iPhone 4, in 2010.

The world market leader responded by launching its own phones with touch screens. In addition, Nokia also launched a complete download music service. Referring to the new download service, Rob Wells, senior Vice President for digital music at Universal, commented: 'This is a giant leap towards where we believe the industry will end up in three or four years' time, where the consumer will have access to the celestial jukebox through any number of devices.' Equally, an industry commentator explained: '[For Nokia] it could be short-term pain for long-term gain. It will steal some of the thunder from the iPhone and tie users into the Nokia service.' Readers will read this comment with some amazement given the subsequent history of Nokia's smartphones that is described in Case 9.2.

'Nokia is going to be an internet company. It is definitely a mobile company and it is making good progress to becoming an internet company as well,' explained Olli Pekka Kollasvuo, Chief Executive of Nokia. There also were hints from commentators that Nokia was likely to make a loss on its new download music service. But the company was determined to ensure that Apple was given real competition in this new and unpredictable market.

Here lay the strategic risk for Apple. Apart from the classy, iconic styles of the iPod and the iPhone, there was nothing that rivals cannot match over time. By 2007, all the major consumer electronics companies – like Sony, Philips and Panasonic – and the mobile phone manufacturers – like Nokia, Samsung and Motorola – were catching up fast with new launches that were just as stylish, cheaper and with more capacity. In addition, Apple's competitors were reaching agreements with the record companies to provide legal downloads of music from websites – described in more depth in Case 13 at the end of this book.

Apple's competitive reaction

As a short term measure, Apple hit back by negotiating supply contracts for flash memory for its iPod that were cheaper than its rivals. Moreover, it launched a new model, the iPhone 4, that made further technology advances. Apple was still the market leader and was able to demonstrate major increases in sales and profits from the development of the iPod and iTunes. To follow up this development, Apple launched the Apple Tablet in 2010 – again an element of risk because no one really knew how well such a product would be received or what its function really was. The second generation Apple tablet was then launched in 2011 after the success of the initial model. But there was no denying that the first Apple tablet carried some initial risks for the company.

All during this period, Apple's strategic difficulty was that other powerful companies had also recognised the importance of innovation and flexibility in the response to the new markets that Apple itself had developed. For example, Nokia itself was arguing that the markets for mobile telephones and recorded music would converge over the next five years. Nokia's Chief Executive explained that much greater strategic flexibility was needed as a result: 'Five or ten years ago, you would set your strategy and then start following it. That does not work any more. Now you have to be alert every day, week and month to renew your strategy.'

If the Nokia view was correct, then the problem for Apple was that it could find its market-leading position in recorded music being overtaken by a more flexible rival – perhaps leading to a repeat of the Apple failure 20 years earlier to win against Microsoft. But at the time of updating this case, that looked unlikely. Apple had at last found the best, if risky, strategy.

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Case questions

- 1 *Using the concepts in Chapter 1, undertake a competitive analysis of both Apple and Nokia – who is the stronger?*
- 2 *What are the problems with predicting how the market and the competition will change over the next few years? What are the implications for strategy development?*
- 3 *What lessons can other companies learn from Apple's strategies over the years?*