

Why the iPhone Won't Last Forever



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The iPhone's success

- Impressive start . . .
 - Sales of iPhones rose 7 percent in the quarter ending in late September.
 - More than 30m have been sold so far, 5.2m in the quarter ending in June.
 - Its share of the American market is pushing 14%.
- . . . that won't last forever
 - In the first quarter of 2009, RIM's BlackBerry Curve moved past Apple's iPhone to become the best-selling consumer smartphone in the United States

What the critics are saying

- “Now, as ‘kings of the jungle’ [the incumbent carriers] demand and get exclusive device deals to further increase their market share.”
 - Hu Meena, President Cellular South, *Wall Street Journal*, July 13, 2009
- “And smaller competitors are hurt if they can't get access to the devices consumers crave.”
 - *USA Today*, July 9, 2009
- “The FCC must ‘take action to prevent the dominant cell phone providers from gaining exclusive access to the most in-demand cell phones.’”
 - Sen. Herbert Kohl, Letter to DOJ, July 6, 2009

Regulators turn up the heat

- Senate Commerce Committee holds hearing in summer
- Sen. Kohl writes letter to DOJ, which may be investigating wireless practices
- FCC plans to examine handset exclusivity issue

Droid is targeting the iPhone

iDon't have a real keyboard.

iDon't run simultaneous apps.

iDon't take pictures in the dark.

iDon't customize.

iDon't run widgets.

iDon't allow open development.

iDon't take pictures in the dark.

iDon't have interchangeable batteries.

Everything iDon't

DROID DOES

The first iconic handset

- “Portable phones won’t get a lot smaller than this one. After all, they have to reach from your ear to your mouth.”
 - Fortune Magazine, 1989



Motorola's MicroTAC flip phone

History of iconic handsets

Company	Model	Year Introduced	Exclusive (w/ whom)
Motorola	MicroTAC	1989	
Motorola	StarTAC	1996	
Nokia	9000 Communicator	1996	
Handspring	Treo 180	2002	
Motorola	Razr V3	2004	AT&T
Danger	Sidekick	2002	T-Mobile
RIM	Blackberry Pearl	2006	T-Mobile
RIM	Blackberry Curve	2007	AT&T
Apple	iPhone	2007	AT&T
Palm	Pre	2009	Sprint
HTC	G1	2009	T-Mobile

Under what conditions should exclusives be banned?

- One of the firms seeking an exclusive agreement must “dominate” access to consumers
- The excluded product is needed by the dominant firm’s rivals to constrain the prices the dominant firm can charge

Does any wireless carrier dominate access to customers?

- AT&T had roughly a 29 percent share of the U.S. wireless market.
- Verizon (31%), T-Mobile (12%), and Sprint (11%) also lack downstream market power.
- Implication: No carrier could demand exclusivity as a condition of carrying a handset, with the intent to prevent rival carriers from gaining a foothold

Is the iPhone a “must-have” input?

Feature	Palm Pre	Blackberry Storm	Nokia N97	HTC G1
(1) Syncs with iTunes	Yes	Yes	Yes	Yes
(2) Supports tens of thousands of applications	Not Yet	Over 1000	Hundreds	Thousands
(3) Touch screen	Yes	Yes	Yes	Yes
(4) Video streaming	Yes	Yes	Yes	Yes
(5) 3G Network	Yes	Yes	Yes	Yes
(6) Digital camera	Yes	Yes	Yes	Yes
(7) GPS chipset	Yes	Yes	Yes	Yes

Efficiency rationales for exclusive handset agreements

- Exclusive handset contracts are motivated for three procompetitive reasons:
 - to share the enormous risk associated with launching a new device
 - to align the incentives of the carrier with the handset maker
 - to ensure network quality

Disruptive technologies on the horizon

- Improved networks
 - WiMAX
 - LTE
- Improved operating systems
 - Symbian OS
 - RIM's BlackBerry OS
 - Microsoft's Windows Mobile
 - Google's Android
 - Linux Mobile



Weigh the costs and benefits

- Costs of banning exclusives would be significant
 - Carriers would have weaker incentives to aggressively promote new devices and to ensure network quality
 - Less innovation
- Benefits of banning exclusives would be modest at best
 - Possible price effects, but competition is already intense

Policy implications

- Because costs of intervention exceed benefits, exclusive agreements should generally be permitted
- At a minimum, FCC could examine complaints on a case-by-case basis, but ex ante ban cannot be defended on economic grounds

Contact information

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