

In dull retail environment, smart phones shine

October 28 2010, By Jeff Gelles

The 14 million iPhones that Apple sold in its latest quarter are more than a bright flare on one of Silicon Valley's greatest stars. The iconic Apple smart phone also represents the leading edge of a wireless revolution that is finally delivering on the decade-old promise of a mobile Internet.

Analysts say smart phones' huge success -- various phones based on Google's [Android](#) operating system are expected to outpace iPhone sales for the year -- is driven by a mix of pull and push.

The pull comes from the tens of millions of cell phone users who want to own the coolest new gadgets and are finding new uses for video-on-the-go and for apps -- short for "applications," and the second new word the smart phone revolution has popularized, after "smart phone" itself.

The push comes from wireless companies that, despite a lousy economy and otherwise reluctant consumers, have found that they can dramatically boost their revenues by upgrading customers to the newest, data-hungry devices. They sell well despite prices of \$200 or more.

For consumers who have money in the bank, and perhaps even for some who don't, the lure of the newest new thing remains powerful, according to industry watchers such as Ed Finegold, chief analytics officer at Validas, a Texas company that analyzes cell phone statements to help consumers, businesses and governments control costs.

"There's such a strong lifestyle aspect -- such strong social cachet -- to a

smart phone," Finegold said. "It's the must-have toy for adults, and it makes a social statement."

While consumers are lured by dazzle, carriers and handset makers are driven by dollars, analysts say.

Apple reported all-time records in revenue and profits for the most recent quarter, driven largely by a 91 percent jump in sales of the new [iPhone 4](#) compared with sales of earlier models in the same quarter in 2009.

Apple has discovered what the carriers and traditional handset makers already knew: The [cell phone](#) market is driven not just by cool new devices, but by the leading carriers' contract and marketing strategies. And both are geared toward encouraging consumers to see phones as nearing obsolescence within two years -- a faster life cycle than that of any other major product, even in the rapidly changing field of consumer electronics.

"What's the life span of a wireless device -- 12 months, 18 months?" Finegold said. "Most people upgrade their phones even before their contracts come up."

Finegold said that more than 200 million U.S. wireless customers are in the "post-paid" market, where the major carriers dominate and consumers are typically under contract.

"Within 18 months the thing is scratched and beat up, and there is something new on the market. Somewhere between a year and 18 months, people are ready for a new device," Finegold said.

The carriers fine-tune their handset subsidies to encourage product turnover, and then use the subsidies as justification to tie consumers to

contracts with stiff penalties for early termination.

As new [smart phones](#) come onto the market, the revenue opportunities are enormous, Finegold said. "You can take a \$50- or \$60-a-month customer and turn them into a \$90- or \$100-a-month customer," he said.

Thanks largely to the iPhone, AT&T has lately led the way toward the smart-phone revolution, said Jeff Kagan, an Atlanta telecommunications analyst. "Fifty-three percent of every phone they sell is a smart phone," he said. "Verizon is at 36 or 37 percent."

Android-based phones such as Verizon's Droid are expected to capture 35 percent of all U.S. smart-phone sales in 2010 versus 27 percent for iPhones, said Matthew Goodman of New York's Majestic Research. Verizon is also expected to introduce its own version of the [iPhone](#) in the first quarter of 2011, ending AT&T's exclusivity.

And in early November, Microsoft is expected to release its all-new smart-phone platform, known as Windows Phone 7. Goodman said phones using the Microsoft platform will be offered initially by AT&T and T-Mobile and will be made not just by traditional handset manufacturers but also by Dell, the personal computer maker.

Overall, the smart-phone revolution has contributed to a remarkable reshuffling of many business fortunes.

Right now, the industry is led by two wireless outsiders -- Apple and [Google](#). And some early leaders in the wireless Internet, such as Research in Motion, maker of the BlackBerry, are struggling to play catch-up.

Don't count anyone completely out, Kagan said.

Ten years ago, Motorola still dominated the industry with its StarTAC phone, a clamshell analog device. "It was small and it was cool," Kagan said. It led the market, and it pretty much just made phone calls.

Now Motorola is back, making Verizon's Droid.

"We're in the middle of a great transformation," Kagan said.

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