Samsung looks on as profits migrate to online ecosystems

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The cloud could mean a stormy future for Samsung. Credit: Chris Zielecki, CC BY-NC-SA

There used to be a time when the launch of a Galaxy handset, a Macbook, or a fancy game console could set investor hearts on fire and firms on a path to untold riches. These days, new devices no longer have this effect. It is increasingly hard to tell them apart and they are turning into mere conduits to a world of online software and services.

Most smartphones are rectangular, black, and have a touchscreen; and their insides are standardised too. Mediatek and others no longer just supply chipsets but also entire blueprints for functioning handsets. Most components are available off the shelf, including the popular operating system Android. Karbonn and Micromax led the way in demonstrating how cheap smartphones can be if built in mass. And these can do most things Apple and Samsung's models do, so premium prices are harder to justify.

This commoditisation process is borne out in Samsung's disappointing profits. But companies still keep piling into the hardware market, most recently Tesco and Amazon. These new arrivals view devices rather differently than their predecessors.

Although there is little direct money to be made from hardware that consumers are unable to distinguish, devices are useful for another purpose: as an entry point to an online service ecosystem. Tesco and Amazon want to get people to use their devices for shopping as a matter of course, and they complement their offerings with online media such as Blinkbox and Prime, and in the case of Amazon, also provide storage and other cloud-based services.

Jumping between software and services is seamless within an ecosystem but difficult across. Anyone who has tried to migrate from Facebook to Google+ will attest to this. So once you are in, you are unlikely to leave, which is why tech corporations are trying to push devices into your hands that link up with their service environment. When you buy an Amazon Fire, you actually pay for a Prime subscription. When you opt for a Chromebook Pixel, you are automatically signed up for Google's cloud storage. This will induct you into the respective ecosystems, where most future profit will be generated.

For a few years, access to apps determined whether phones would sell, and most of the value chain profits were extracted by those who linked app store and operating system. Now, it is the apps themselves. With html5 and other trends making apps available across OS platforms, and most data processing occurring in the cloud, not on the device, the makers of apps themselves stand to benefit more. And since interoperability between apps (akin to the Microsoft Office suite in the world of PCs) makes life easier, a few dominant software providers will emerge that reap the greatest share of value chain profits.

Hence, the race for dominant ecosystem platforms. Apple, Google and Amazon have worked long and hard to build an increasingly varied service offering, touching on most parts of our daily lives. Facebook has realised this too and is now diversifying its app portfolio, as is Tesco, albeit against greater odds. GE, or General Electric, reportedly aims to become a top-ten software firm.

Abroad, Alibaba, Baidu, and Tencent are similarly busy, and Xiaomi, a much-watched tech entrant, also gets its money from services despite building phones. Even Sony now increasingly aims to generate income from gaming subscriptions rather than just consoles.

In a cloud-based world, devices of course still serve a purpose. They are the physical sensors needed for virtual computing. Your handset might take a picture, which is edited and stored online. Your device's gyroscope enables online gaming, and your thermostat feeds into your online home management platform. Devices are thus still necessary, but easily provided.

Therefore, the innovation potential that excites investors might no longer be in hardware. Even future devices such as wearables that haven't been properly developed and adopted yet, let alone commoditised, will hardly sustain a new bonanza. Their usefulness again depends on the link with a powerful online platform. Google Glass is nothing without Google.

Which leaves Samsung, a largely hardware-only firm, rather exposed. The company has pushed Tizen as a handset operating system alternative, which could be extended to smarthome devices and the like.

But the consumer perception is not one of great software and services. It looks as if it is almost too late to change this. Perhaps Samsung will opt to move downmarket, capitalising on its scale of production. Or it might concentrate on building devices that continue to process locally, such as washing machines.

Samsung is not alone in its predicament. HP, HTC, and Nokia are a few that come to mind. But this does not diminish the threat of becoming the extended workbench of online corporations. Making fancy devices is no longer a reliable indicator of profit – look out for the online possibilities they connect to.

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