

**APPLE'S
THREE
LEADERS
SAY
THEY'VE
NEVER
BEEN MORE
COMMITTED
TO A
SINGLE
STRATEGY**

ITION



**Jony Ive,
head of design**

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Apple's doomed. This is what you hear and read. Sure, it was a hell of a run—iPhone, iPad, all that—but it's about to end, and fast. If you need any proof, just look at China: the world's largest smartphone market, flooded with ever-cheaper handsets and tablets from domestic manufacturers that didn't even exist when the iPhone was first announced. You think those cheap handsets and tablets will confine themselves to the Middle Kingdom? Of course not—China will be the epicenter of a global collapse in device prices. The competition will be beyond Thunderdome, fought by companies armed with little more than a free operating system from Google and razor-thin profit margins. The Cupertino (Calif.) maker of chamfered-edged, precision-etched baubles? Toast. Check Apple's stock price, down around 33 percent since its peak about a year ago.

None of this rattles Tim Cook. Oh, he's heard it, of course, but his soft-spoken, deliberate manner in interviews is not cover for how, say, Apple's share price affects his mood. "I don't feel euphoric on the up, and I don't slit my wrists when it goes down," he says. "I have ridden the roller coaster too many times for that." When asked about the rise of low-cost manufacturers, he's equally even-tempered. "It happens in every market I've seen," he says. "It happens in all consumer electronics, from cameras to PCs to tablets to phones to—in the old world—VCRs and DVDs. I can't think of a single consumer electronics market it doesn't happen in."

Cook, 52, is sitting in a sunlit conference room on the top floor of Apple's main building. He's wearing a navy polo, dark trousers, and his signature, rectangular rimless eyeglasses. It's two days after he introduced Apple's latest smartphones, the iPhone 5S and iPhone 5C. When he entered, the first thing he wanted to know was what I thought of the new handsets. (The 5C looks good. I like the 5S, too, though the white-and-gold model has a flashy, Emirates airline vibe.)

To Cook, the mobile industry doesn't race to the bottom, it splits. One part does indeed go cheap, with commoditized products that compete on little more than price. "There's always a large junk part of the market," he says. "We're not in the junk business." The upper end of the industry justifies its higher prices with greater value. "There's a segment of the market that really wants a product that does a lot for them, and I want to compete like crazy for those customers," he says. "I'm not going to lose sleep over that other market, because it's just not who we are. Fortunately, both of these markets are so big, and there's so many people that care and want a great experience from their phone or their tablet, that Apple can have a really good business."

For longtime followers of Apple, this has a familiar ring. Responding to similar skepticism in 2004, Steve Jobs, the company's late co-founder, said, "Apple's market share is bigger than BMW's or Mercedes's or Porsche's in the automotive market. What's wrong with being BMW or Mercedes?" That was before Apple came tantalizingly close to total domination in several product categories (in one, the iPod, the company effectively established a monopoly) and reset expectations of what it could do, especially on Wall Street. Now, six years after the release of the original iPhone, Apple no longer has the mobile marketplace to itself. It has to square off against giants such as Samsung Electronics; previous mobile all-stars Motorola and Nokia, which are now respectively part of Google and (soon) Microsoft; and a rash of new rivals such as Xiaomi of China and Micromax of India that can undersell anybody. Is taking the high road truly a sustainable strategy, or does it merely delay the inevitable?

The past 12 months have been unusually active at Apple. The company added the iPad Mini to its lineup, renovated its top-of-the-line smartphone with the 5S, expanded the iPhone line with the 5C, and released iOS 7, the most significant upgrade to its mobile operating system in years. And it managed all that while adding a low-carb "paleo" food station to its cafeteria. It also reshuffled its executive ranks, showing talented-but-divisive

"THERE'S ALWAYS A LARGE JUNK PART OF THE MARKET," COOK SAYS.

"WE'RE NOT IN THE JUNK BUSINESS"

iOS chief Scott Forstall the door and splitting his responsibilities between Jonathan Ive, Apple's chief designer, and Craig Federighi, who heads software at the company.

The partnership of Ive and Federighi is crucial in delivering the great experience Cook extols. Ive, 46, is already a design world icon; it's his invisible signature on the iMac, iPod, iPhone, and iPad. His minimalist videos are a staple of Apple events, where he talks about the "machined surfaces" and "remarkable precision" of the company's products. Indeed, when describing the lower-cost iPhone 5C on Sept. 10, Ive highlighted the phone's cheaper materials and tried to turn them into a virtue by describing it as "beautifully, unapologetically plastic." (Some guffaws were heard in the auditorium.)

Federighi, who's 44, started working for Jobs at Next, the company Jobs founded after being pushed out of Apple in 1985. In 1996, Apple purchased Next, and Federighi worked at Apple for three years before going to Ariba, a software company that helps businesses manage their purchasing. He returned to Apple in 2009. As senior vice president of software engineering, Federighi lives up to his nerdy title with self-effacing humor. He jokingly referred to his love of prog rockers Rush onstage at the iPhone event, and he speaks guilelessly about his affection for Apple and its products: "I think probably if someone mapped my brain, you would find there were moments where I lit up the love pattern in my neurons in association with our products."

Federighi and Ive are seated in a ground-floor conference room, just off of a lobby decorated with black-and-white photos of MacBook Airs and other Apple products. Ive is of average height and has a shaved head; Federighi is quite tall and has a mane of gray hair—his nickname is "Hair Force One." Neither could be described as slick; that was more Forstall's thing. They're both articulate and earnest and share the fanatical attention to detail that Jobs instilled in Apple at a chromosomal level.

While the partnership between the two men was made official last fall, Ive and Federighi—whose desks are a one-minute walk from one another—have been working together for years. "I don't think we ever talked about our roles," Ive says. "We talked about how can we most effectively extend the collaboration that always existed."

That collaboration isn't just there to make people feel good. It's what's needed as Apple ventures into a more challenging time. You cannot have internally warring factions when you're also under attack from the outside. "Successful collaboration, in your mind,

could be that your opinion is the most valuable and becomes the prevailing sort of direction,” Ive says. “That’s not collaborating.”

What makes that collaboration work is the two men’s shared focus on usability and simplicity. Sit down with top executives from, say, Samsung’s mobile division, and you’ll probably hear a great deal about how much the company listens to the market and can move to address global needs with astonishing alacrity. Ive and Federighi will spend 10 minutes talking about how hard they worked to perfect iOS 7’s blurred-background effect. “I think, very often, you can’t call out by attribute or name areas of value,” says Ive regarding what people look for when using a product. “But I do think that we sense when somebody has cared. And one thing that is incontrovertible is how much we’ve cared.”

The line against Apple is that its pace of innovation is off, but Ive and Federighi dismiss that. The two are keen to point out not just new features, but also the deep layers of integration that went into each one. Of the 5S’s fingerprint scanner, Ive says, “there are so many problems that had to be solved to enable one big idea.” Without mentioning competitors (Samsung), it’s clear the two executives think some of what passes for innovation is illusory at best. “We didn’t start opportunistically with 10 bits of technology that we could try to find a use for to add to our features list,” Ive says.

Federighi jumps in: “New? New is easy. Right is hard.”

Two mobile trends have been working against Apple: the continuing rise of Android and the fall of prices. On the Android front, Google’s free and open operating system continues to dominate the mobile landscape: According to market researcher IDC, Android runs on nearly 80 percent of the world’s smartphones and nearly two-thirds of its tablets. Since the beginning of last year, says IDC, the average unsubsidized price for a smartphone fell from \$450 to \$375. (Unsubsidized means the phone’s full price, without any discount that comes with a multiyear contract. That’s how most people outside the U.S. buy mobile phones.) The iPhone 5S sells for \$650 and up, unsubsidized. “We’re at a place now where Apple’s not a laggard, but others have been capitalizing on the low end of the smartphone market,” says Charles Golvin, an analyst at Forrester Research.

Anticipation surrounding the iPhone 5C was focused primarily on its price. No one expected Apple to come out with a bargain-basement model to really take it to low-cost Chinese makes, but perhaps a smartphone that retailed for \$300—something just inexpensive enough to make it attractive to, say, brand-conscious strivers in Shanghai. “There are still a lot of people in developing markets who don’t have an iPhone, but would buy one if the price were lower,” says Golvin. “There’s a lot of pent-up demand.”

The 5C didn’t come out at \$300. It costs \$550 unsubsidized—only

\$100 less than the top-of-the-line 5S. “We never had an objective to sell a low-cost phone,” says Cook. “Our primary objective is to sell a great phone and provide a great experience, and we figured out a way to do it at a lower cost.”

That lower cost will have to be apparent in countries such as China, which is too big a market for Apple to ignore. That’s why the company has been signing deals with China Unicom and China Telecom and has been courting the country’s largest wireless carrier, China Mobile. With more than 700 million subscribers, China Mobile has more than three times the customers of AT&T and Verizon Wireless combined. While Chinese carriers do reduce the prices of phones with rebates and discounts, the iPhone 5S and 5C still start at a much higher price than the domestic brands. “It raises the question: Is Apple truly a mass-market provider?” says Benedict Evans of Enders Analysis. “Or do they wind up with 40 percent of the U.S. market, a third of Europe, and nothing anywhere else?”

Android, meanwhile, continues to increase its market share, as its code shows up in high-end phones such as Samsung’s Galaxy S4 as well as handsets and tablets that run a limited, or “forked,” version that has no connection back to Google. Amazon.com’s Kindle Fire tablets use a forked version of Android. “One thing that clearly surprised Apple and everyone else was how quickly Android took off,” says analyst Horace Dediu of Asymco, a research firm in Helsinki.

Android’s growth has far more important implications than just bragging rights. Developers tend to make apps for iOS before coming up with a version for Android. If Android continues to show up on more devices, the order could flip. As of 2013’s second quarter, Apple’s App Store generated 2.3 times more revenue than Google’s app store, Google Play, according to App Annie, an analytics firm. But Google Play had 10 percent more downloads overall. It’s one thing to cede a portion of the market because it’s racing toward the lowest possible price, but what if that market becomes the center of gravity for the entire industry?

“The truth about the mobile marketplace is that trends rise and fall far more violently than anyone ever expects,” says Tero Kuittinen, an analyst at Alekstra, a research firm. “At a certain point, growth becomes more important than absolute levels, so even if Apple is currently sending more money to developers than Android, if Android’s growth is faster than Apple’s, developers will bail and go to Google Play.”

“I think it’s even more a two-operating-system world today than it was before,” Cook says. But, he adds, “when you look at things like customer satisfaction and usage, you see the gap between Android and iOS being huge.”

This leads Cook to a point he makes a lot: People may buy

Not What You Use. How You Use It

“I don’t measure our success in unit market share,” says Tim Cook. Good thing, as Apple’s never been the market leader by that metric. But usage statistics, Cook’s preferred measure, paint a different picture.

Top smartphone operating system in U.S.

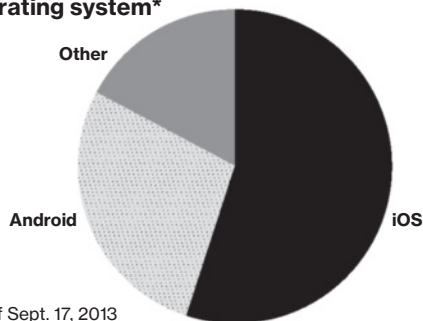
2005	Palm
2006	Microsoft
2007	Microsoft
2008	RIM
2009	RIM
2010	RIM
2011	Android
2012	Android
2013	Android

Top 3 global handset brands

	First	Second	Third
2005	Nokia	Motorola	Samsung
2006	Nokia	Motorola	Samsung
2007	Nokia	Motorola	Samsung
2008	Nokia	Samsung	Motorola
2009	Nokia	Samsung	LG
2010	Nokia	Samsung	LG
2011	Nokia	Samsung	Apple
2012	Samsung	Nokia	Apple

Longtime handset champ Nokia lost its title in the smartphone era

Mobile Web traffic by operating system*



*As of Sept. 17, 2013



Android devices, but the ones they actually use have an Apple logo on the back. According to Web analytics company NetMarketShare, nearly 55 percent of all mobile Web activity comes from devices running iOS. Android devices made up only 28 percent. Last Black Friday, the iPad accounted for more than 88 percent of online shopping traffic from tablets, according to an IBM survey. “Does a unit of market share matter if it’s not being used?” Cook asks. “For us, it matters that people use our products. We really want to enrich people’s lives, and you can’t enrich somebody’s life if the product is in the drawer.”

Then there’s the matter of Android’s fragmentation into many versions. “I don’t think of Android as one thing,” Cook says. Unlike Apple, which makes one operating system and releases a major upgrade periodically, Google creates new versions of Android, but not all Android users have been able to upgrade to the latest release. Since Android is often heavily modified by both handset makers and wireless carriers, updates can be delayed as multiple parties coordinate their schedules. Google says 45 percent of its users are on the latest version of Android, “Jelly Bean.” But 31 percent are still on “Gingerbread,” which came out at the end of 2010. An additional 22 percent are on “Ice Cream Sandwich,” which was released in October 2011. According to Apple, 93 percent of its users were on iOS 6 at the end of June (iOS 7 was made available on Sept. 18).

In Cook’s view, the incompatibilities between various Android versions make each an entirely different species. The Android

operating systems are “not the latest ones by the time people buy,” he says. A recent survey of smartphones sold by AT&T showed 25 Android handsets; six did not have the latest operating system. “And so by the time they exit, they’re using an operating system that’s three or four years old. That would be like me right now having in my pocket iOS 3. I can’t imagine it.”

Fragmentation creates complexity and what Cook calls a “compounding problem.” “It will show up in developers,” he says. “It will show up for people that no longer have access to certain apps. It will show up in security issues because if you’re not moving your customer base to the latest version, then you have to go back and plug holes in all of this old stuff, and people don’t really do that to a great degree.” Gina Scigliano, a Google spokeswoman, wrote in an e-mail that “the measures we have in place are protecting consumers.”

You could say that Apple’s approach in mobile ignores history, specifically the Mac/Windows wars of the 1990s, which Apple clearly lost. In this scenario, Android is Microsoft’s Windows—available to all kinds of manufacturers—while iOS is on only Apple devices. Microsoft made money by charging Dell, Hewlett-Packard, and others to put Windows on their PCs, and Apple’s market share shriveled. Google gives Android away for free, but the thinking there is the more people you can get online via mobile devices, the more they will search and consume Web content, which helps the online ad market. As Google handles more online advertising than anyplace else, a rising online tide benefits its bottom

line. Cook finds the Microsoft analogy misleading. “Microsoft kept things the same, and the level of fragmentation wasn’t as much,” he says. “There weren’t so many derivative works out there with Windows.”

The great irony here is that Apple’s rivals are trying to be more like Apple by integrating hardware and software. In 2011, Google purchased Motorola Mobility and began to design Android handsets in-house. Earlier this month, Microsoft announced it was purchasing Nokia’s device business for \$7.2 billion. “Everybody is trying to adopt Apple’s strategy,” Cook says in regard to the Nokia purchase. “We’re not looking for external validation of our strategy, but I think it does suggest that there’s a lot of copying, kind of, on the strategy and that people have recognized that importance.”

If one part of Nokia’s story is validating, the other is cautionary. When Apple got into the mobile business, it was Nokia’s world. The Finnish company was considered something of a miracle worker. “I’m old enough to remember when Nokia had margins of 25 percent, and there was absolutely no way they were going to be dislodged from their leadership position,” says Kuittinen of research firm Alekstra. Says Cook, “I think [Nokia] is a reminder to everyone in business that you have to keep innovating and that to not innovate is to die.”

“Innovate or die” is no longer just a mantra for Cook; it’s a common refrain from Apple’s fans and critics. Since Jobs’s return to Apple in 1996, the company has grown not by inventing devices, but by perfecting them and creating markets. Apple didn’t make the first music player. It didn’t make the first smartphone or tablet, but it did turn them into things that people are willing to camp out overnight to buy.

Apple has set a pace for itself that can be hard to keep up. Like it or not, every time Cook walks onstage and unveils anything less than a mind-blower, the world—or at least the stock market—reacts with disappointment. Apple shares dropped 5 percent the day the new iPhones were introduced and are down about 10 percent for the year. “Am I happy about that? No, I’m not,” Cook says. “You have to bring yourself back to, ‘Are you doing the right things?’ And so that’s what I focus on, instead of letting somebody else or a thing like the market define how I should feel.” **B**

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