**Case 20: Apple Inc.**

***Taking a Bite Out of the Competition***[***\****](https://jigsaw.vitalsource.com/books/0077653017/content/id/FNcase20-1)

In January 2011 came the news that Apple’s visionary leader and CEO, Steve Jobs, would be taking yet another medical leave of absence. He did not say when he would return or why he was leaving, but the hints were ominous. The announcement prompted speculation of the return of pancreatic cancer, which was the cause of previous medical leaves by Jobs. In a letter to his 50,000 employees, Jobs handed off daily control of the company to Apple’s chief operating officer, Timothy D. Cook. He referred to his management team’s plans for 2011 and sounded an unusual emotional note: “I love Apple so much and hope to be back as soon as I can.”[**1**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-1)

For shareholders, the announcement of Jobs taking another medical leave was troubling news. Apple Inc. shares dipped, and investors voiced their concerns for the future of the world’s largest technology firm. It posed yet again the unavoidable question that now loomed over 35-year-old Apple: What happens to a modern company whose innovations and inspirations are so closely tied to the vision of one leader when that leader’s influence is in decline?[**2**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-2)

The company tried to downplay the impact of his departure. It tried to bury the news by announcing it on January 17, the Martin Luther King holiday in the United States, and then by presenting blowout financial results the next day. During a call with stock-market analysts, Cook said, “We feel very confident about the future of the company.” Apple had every reason to be confident.[**3**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-3) In the 2011 first quarter, Apple reported $26.7 billion in revenue, up 70 percent from a year before (see [**Exhibits 1**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Excase20-1) and [**2**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Excase20-2)).[**4**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-4) Although Apple may have mapped product plans for 2012 and beyond, analysts believed that without Jobs’ stubbornness and obsession about process and product details, Apple would never be the same.

Apple, at the top of *BusinessWeek*’s Most Innovative Companies list since 2004,**[5](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-5)** had distinguished itself by excelling over the years not only in product innovation but also in revenue and margins (since 2006 Apple had consistently reported gross margins of around 30 percent). Founded as a computer company in 1976 and known initially for its intuitive adaptation of the “graphical user interface” or GUI (via the first mouse and the first onscreen “windows”),**[6](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-6)** Apple had dropped the word *computer* from its corporate name in 2007. Apple Inc. in 2010 was known for having top-selling products not only in desktop (iMac) and notebook (MacBook) personal computers but also in portable digital music players (iPod), online music services (iTunes), mobile communication devices (iPhone), digital consumer entertainment (Apple TV), handheld devices able to download third-party applications, including games (iPod Touch via the App Store), and, recently, tablet computers (iPad) (see [**Exhibit 3**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Excase20-3)).

## Steve Jobs’s Return

One of Jobs’s first strategies on his return was to strengthen Apple’s relationships with third-party software developers, including Microsoft. In 1997 Jobs announced an alliance with Microsoft that would allow for the creation of a Mac version of the popular Microsoft Office software. He also made a concerted effort to woo other developers, such as Adobe, to continue to produce Mac-compatible programs.

In late October 2001, Apple released its first major noncomputer product, the iPod. This device was an MP3 music player that packed up to 1,000 CD-quality songs into an ultraportable, 6.5-ounce design: “With iPod, Apple has invented a whole new category of digital music player that lets you put your entire music collection in your pocket and listen to it wherever you go,” said Steve Jobs. “With iPod, listening to music will never be the same again.”[**10**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-10)

This prediction became even truer in 2002, when Apple introduced an iPod that would download from Windows—its first product that didn’t require a Macintosh computer and thus opened up the Apple “magic” to everyone. In 2003 all iPod products were sold with a Windows version of iTunes, making it even easier to use the device regardless of computer platform.

In April 2003, Apple opened the online iTunes Music Store to everyone. This software, downloadable on any computer platform, sold individual songs through the iTunes application for 99 cents each. When announced, the iTunes Music Store already had the backing of five major record labels and a catalog of 200,000 songs. Later that year, the iTunes Music Store was selling roughly 500,000 songs a day. In 2003 the iPod was the only portable digital player that could play music purchased from iTunes, and this intended exclusivity helped both products become dominant.

After 30 years of carving a niche for itself as the premier provider of technology solutions for graphic artists, Web designers, and educators, Apple appeared to be reinventing itself as a digital entertainment company, moving beyond the personal computer industry. The announcement in 2007 of the iPhone, a product incorporating a wireless phone, a music and video player, and a mobile Internet browsing device, meant Apple was also competing in the cell phone/smartphone industry.

In 2011 Apple expanded the iPhone to operate on the Verizon network along with AT&T’s network. The company introduced the iPod Touch, a portable media player and Wi-Fi Internet device that allowed users to purchase and download music directly from iTunes without a computer. Applealso opened the App Store. Users could now purchase applications written by third-party developers specifically for the iPhone and iPod Touch. These applications included games, prompting analysts to wonder whether Apple was now becoming a competitor in the gaming market.

Apple was becoming a diversified digital entertainment corporation (see [**Exhibit 4**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Excase20-4)). Analysts had already believed Apple had “changed the rules of the game for three industries—PCs, consumer electronics, and music … and appears to have nothing to fear from major rivals.”[**11**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-11) On top of steady sales increases of its computers sales and of the iPod/iTunes, the added categories of iPhone and iPad were showing substantial growth. Apple was now taking bites out of the competition on all fronts (see [**Exhibit 5**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Excase20-5)).

## Apple’s Operations

Maintaining a competitive edge required more than innovative product design. Operational execution was also important. For instance, while trying to market its increasingly diverse product line, Apple believed that its own retail stores could serve the customer better than could third-party retailers. By the end of 2010, Apple had an average of 317 stores open, including 84 international locations, with average store revenue of about $34.1 million.[**12**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-12) In addition to the “Genius Bars” Apple had installed in its own retail stores, Apple also invested in programs to enhance reseller sales, including the placement of Apple employees and knowledgeable contractors at selected third-party reseller locations. The company explained that it “believes providing direct contact with its targeted customers is an efficient way to demonstrate the advantages of its … products over those of its competitors.”[**13**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-13)

In further operational matters, regarding a head-to-head competition against Dell in the computer market, for instance, Steve Jobs was quick to point out that market share wasn’t everything. While Dell’s perceived dominance might have been partly the result of its efficient supply-chain management, Apple had outperformed Dell in inventory and other metrics since 2001.[**14**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-14) In addition, Apple had the best margins, partly because of its simpler product line, leading to cheaper manufacturing costs.[**15**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-15) In 2010 Apple beat Dell and HP (as well as Nokia, IBM, Samsung, and Sony Ericsson) and took the number-one spot on AMR Research’s Supply Chain Top 25.[**16**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-16)

Regarding suppliers of components for Apple’s diverse products, Apple had entered into certain multiyear agreements with suppliers of key components, including microprocessors, NAND flash memory, dynamic random access memory (DRAM), and LCD displays. Some of these long-term supplier-agreement partners included Hynix Semiconductor, Intel Corporation, Micron Technology, Samsung Electronics, and Toshiba Corporation. Also, in addition to using its own manufacturing facilities in Ireland, Apple had been outsourcing manufacturing and final assembly of iMacs, iPods, and iPhones to partners in Asia, paying close attention to scheduling and quality issues.

Supply chain and product design and manufacturing efficiencies were not the only measures of potential competitive superiority. Apple had also historically paid attention to research and development, increasing its R&D investment year after year. In 2010, Apple spent $1.8 billion on R&D, an increase from $1.3 billion in the previous year.[**17**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-17) Among its current rivals, Apple’s R&D investment was beaten only by Microsoft, Hewlett-Packard, and Google.[**18**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-18)

## Status of Apple’s Business Units in 2011

## The Apple Computer Business

In the computer market, Apple had always refused to compete on price, relying instead on its reliability, design elegance, ease of use, and integrated features to win customers. Some analysts believed Apple had the opportunity to steal PC market share as long as its system was compatible, and no longer exclusively proprietary, and offered upgrades at a reasonable cost.[**19**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-19) But the real opportunity for increased market share was the Intel-based iMac desktop and the MacBook/MacBook Pro portable, both using the Intel Core Duo processor. The only part of the computer system not designed and manufactured by Apple was this processor and the memory.

In October 2010 Apple introduced a newer, lighter, redesigned version of the MacBook Air, the “world’s thinnest notebook.” The new MacBook Air combined features of the iPad with the notebook.[**20**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-20) Although the design was considered “revolutionary,” the stripped-down product did not have an optical drive except as a separate external purchase, had limited connectivity with only one USB port, and had a battery that was not user-replaceable. Even so, with its aluminum construction, it was perceived to be sturdy and much easier to carry than other full-size notebooks and therefore most appropriate for travelers in Wi-Fi hotspot areas.[**21**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-21)

The continuing push to convert customers to the Macintosh computing products saw Apple sell 4.13 million Mac computers, both desktops and laptops, worldwide during the first quarter of 2011, an increase of almost 23 percent over the same quarter in the previous year.[**22**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-22) Sales of Applecomputers in the United States did see a decline over the previous quarter, but not as much as the yearly domestic shipments of HP (down 6.1 percent) and Dell (down 6 percent). According to market analysis done by Gartner, the Mac’s domestic market share grew from 7.4 to 9.7 percent, putting it in fifth place overall in Gartner’s survey of PC vendor units shipped in 4Q2010 (see [**Exhibit 6**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Excase20-6)).[**23**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-23)

## Mobile Communication Devices: iPhone

In 2007 further competition came from the blurring of lines between the digital music player and other consumer electronic devices: The telecom players wanted to join the digital music market. While others may have seen the computer as central to the future of digital music, the telecom companies thought the mobile phone could become a center of this emerging world. Apple’s entry, the new iPhone device, combined an Internet-enabled smartphone and video iPod. The iPhone allowed users to access all iPod content and play music and video content purchased from iTunes. Apple made an exclusive arrangement with AT&T’s Cingular Wireless network to provide cellular service.

The iPhone debuted with a 4-GB model for $499 and an 8-GB model for $599, and estimates from component manufacturers suggested it would cost between $230 and $265 to make, yielding Apple’s preferred gross margin of about 50 percent.[**28**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-28) This would allow room for price adjustments based on component or customer demand. The smartphone market in 2007 was estimated at 10 percent of all mobile phone sales, or 100 million devices a year. Steve Jobs said he “would like to see the iPhone represent 1 percent of all mobile phone sales by the end of 2008.”[**29**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-29) This proved to be a conservative estimate.

In July 2008 Apple began selling the iPhone 3G, the second-generation of the iPhone product. The 3G service upgrade accompanied expanded worldwide distribution, through carrier relationships in over 70 countries. Either because of the increased access or because of Apple’s marketing push, 6.9 million iPhone 3Gs were sold in the first quarter of its availability, compared to “6.1 million first-generation iPhone units sold in the prior five quarters combined.”[**30**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-30) As one analyst commented, “When Steve Jobs first introduced the iPhone in 2007, he pointed out that the market for cell phones worldwide was far greater than the market for any other type of consumer electronic device.”[**31**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-31) Worldwide demand for the iPhone was growing: The iPhone was launched in Saudi Arabia and the UAE through Mobily and Etisalat, and got 25,000 subscribers in the first few hours of its availability.[**32**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-32) Now it appeared that Jobs was correct. He had forecast a 1 percent market share of the cell phone market and by 2010 had achieved 2.9 percent

## The Future of Apple

Although Steve Jobs was credited with Apple’s ability to innovate and to appeal especially to a certain type of consumer (Jobs estimated Apple’s market share in the creative-professional marketplace as over 50 percent),**[66](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-66)** Jobs himself credited his people:

We hire people who want to make the best things in the world … our primary goal is to make the world’s best PCs—not to be the biggest or the richest. We have a second goal, which is to always make a profit—both to make some money but also so we can keep making those great products…. [Regarding the systemization of innovation,] the system is that there is no system. That doesn’t mean we don’t have process. Apple is a very disciplined company, and we have great processes. But that’s not what it’s about. Process makes you more efficient … but innovation … comes from saying no to 1,000 things to make sure we don’t get on the wrong track or try to do too much. We’re always thinking about new markets we could enter, but it’s only by saying no that you can concentrate on the things that are really important.[**67**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-67)

Jobs, according to the portrait laid out in countless biographies and articles over the years, is a control freak with a compulsive attention to detail. He routinely sent products back to the lab, killed them in their crib, demanded new features, or euthanized old ones, all while keeping Apple’s attention narrowly focused on just a few products with the potential for high returns. Jobs’ obsession with process and detail even filtered down to how he rolled out products. Besides exhaustively rehearsing his own presentations, he often insisted that executives from partner companies submit to a week or more of dry runs—and has been known to bounce executives at the last minute if they showed signs of nerves that could spoil a Jobs keynote.[**68**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-68)

When Jobs announced he was taking another medical leave, the lingering question on everyone’s mind was obvious: Who will steer the ship when, inevitably, Jobs is gone? Most analysts were enthusiastic about the talents of Tim Cook, who was widely viewed as Apple’s next chief executive if and when Jobs permanently stepped aside. Cook was an operations genius, keen-minded, demanding, and adept at cutting costs while delivering complex products on time and coping with staggering growth targets. He was also monastic and incredibly devoted to Apple. He had oversight of sales, customer support, and logistics—which meant much of the company already reported to him. During Jobs’ previous two absences, Cook steadied the corporate ship so capably that in 2010 he was rewarded with $59 million in salary and stock. Still, during those past medical leaves, Jobs had remained involved in all major strategic decisions, Apple says. In that respect, Tim Cook was untested as a potential CEO.[**69**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-69) Critics claimed that he was a good temporary replacement, but lacked dynamism and creative vision.[**70**](https://jigsaw.vitalsource.com/books/0077653017/content/id/Ncase20-70)