Nokia and Apple: What's market power got to do with it?

As Charlie's previous post highlights, the flip of market dominance between Nokia and Apple has indeed been a powerful illustration of the unprecedented dynamism of modern markets. We tend to learn a lot from such outlier events. Why did a successful organization like Nokia lose its ability to innovate? Why did they miss the market new trends? How could Apple, a complete outsider to the mobile industry, capture such a dominant position?

But one of the risks of learning from unique events is that we tend to oversimplify the lessons. After following the mobile internet market for the last 10 years, and writing three cases about it (the latest one about Nokia's Internet strategy of 2006-2008), I find that my views are more nuanced. Granted, Nokia made big mistakes in the way they managed their mobile Internet strategy. But it is also important to understand the challenges of being an innovator with strong market position in an ecosystems with other powerful players.

Nokia's fulgurant success in the 1990s came at a time of emerging global standards (GSM) but national operators. The opening up of GSM licenses brought new operators, often with weak brands and technological capabilities, into intense competition with national incumbents (the average revenue per user went down by 60% during the 1990s). With their strong brand, user interface, and technology, subsidized Nokia phones became the favourite competitive weapon for European operators to attract and steal customers from each other. This "divide-and-conquer" strategy put Nokia at the peak of its power, and few European operators could afford not having a strong line up of subsidized Nokia phones in the late 1990s.

But the structure of the industry changed drastically by the early 2000s. By 2003, Vodafone, the biggest operator in Europe, had 32% of the subscribers in the top sixteen European countries, and had number 1 or number 2 position in eleven of them. The top four operators in Europe accounted for 65% of subscribers. And these players were not keen on seeing Nokia creating innovations that could potentially challenge the operators' role. When Nokia launched the Club Nokia, a website where Nokia users could download ringtones and graphics directly to their phones (similar to iTunes or the App Store), Vodafone CEO Chris Gent said publicly "if Nokia think they're going to put a Club Nokia button on their phone, they must be joking". Nokia was eventually forced to close Club Nokia (the name is now used by a concern venue in Los Angeles). The early 2000s, at least in Europe, saw a power struggle between operators and Nokia for the supremacy of the ecosystem. Nokia tacitly denied support to operator-led platforms like Vodafone Live or the European rollout of imode, which would have put operators in control of the user experience and technology standards. In exchange, for leading operators, their handset strategy focused on "anyone but Nokia". Despite Nokia's still strong brand image with customers, operators used their channel power to build Asian alternatives like Sharp, Samsung, LG, and HTC.

My point is that the failure to innovate by Nokia was not totally due to an internal inability to generate radical innovations, but to the power concerns by strong ecosystem players. The industry in 2007 was stuck in a trench warfare of incremental innovation – Nokia focused on incremental innovations, mainly in features and form factors, which did not challenge the status quo of the mobile ecosystem model.

In 2007, Apple entered. What is surprising to me of that product introduction was not the features of the product itself (which was of course elegant and user friendly), but Apple's ability as a new comer to change the revenue model in the ecosystem, in a context of powerful operators. The first iPhone (which, by the way, did not include the now popular App Store) was not subsidized by the operators (initial prices where from $500 to $600), but Apple managed to negotiate a 20% to 40% split of the data traffic revenues generated by their handsets. The revenue model was a way for Apple to put their money where their mouth was. The "pay-for-performance" contract reduced adoption risk for operators, since it made money if the iPhone generated the traffic revenues that had been elusive thus far. Also, Apple signed exclusive contracts with operators, to encourage them to use the iPhone as a competitive differentiator.

Can you imagine Nokia going to Vodafone with a proposal to get a share of traffic revenues? I am sure they would have been booted out of the building. Yet, Vodafone agreed to exclusive contracts with Apple in many of its markets (except for the UK, where Telefonica's O2 got the better hand), and so did most of the world's dominant operators. My guess is that at that time, the operators did not feel threatened by Apple, and saw it as a way to bring some dynamism to the sector. Apple's ability to play its original hand, by getting out of the exclusive contracts, maintaining the integrity of its platform, and slowly undermining the power of operators, has been a textbook illustration of how to build power in an ecosystem.

So, what's the lesson? For me, the story shows how hard it is to maintain market leadership through continuous ecosystem innovation if the key channels and complements also have substantial market power. Ecosystem innovation requires coordination and adoption by channels and complementors, but those powerful stakeholders will not support innovations that they perceive as damaging their interests. In hindsight, operators may have missed the challenge that Apple's strategy had for their long-term interest, since Apple increasingly captures the user interaction and technology standards, relegating operators to well paid data pipelines. But because operators perceived Nokia as the powerful player and potential threat, they got into a stalemate that was destructive to the industry.

The story has implications for Apple's future, since powerful operators and ecosystem players are increasingly concerned about its dominance and inflexible practices. Further attempts by Apple to produce radical changes to the ecosystem may be seen with increased suspicion. The quick emergence of Android has been supported by the operators interests to provide alternatives to the iPhone. This also has implications for Nokia's survival in the smartphone segment, since part of Nokia's strategic value today, both to operators and to Microsoft, is to be a credible alternative to an Apple and Google duopoly. So, I don't think Nokia is out quite yet.

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