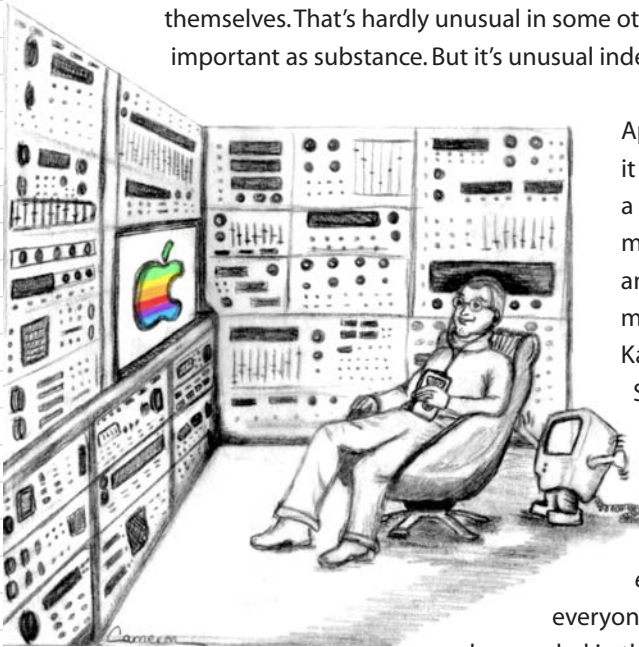




Apple: From Computers to Entertainment?

an Analyst Notebook by Gordon Haff

"If Apple ever has trouble making it as a corporation, it might consider applying for tax-exempt status as a religion," journalist Philip Schrodtt once said. Apple's always had a certain aura about it that's about way more than speeds and feeds. There's a gestalt that keeps customers coming back for more than the virtues of the products themselves. That's hardly unusual in some other arenas, like fashion or automobiles, where image is at least as important as substance. But it's unusual indeed in the more utilitarian computer business.¹



Apple's iconic status isn't just a carefully-crafted brand identity. Nor is it a result only of snazzy technology and innovative design. Rather it's a carefully and (almost) consistently applied mix of the two that makes Apple worth more than the sum of the parts. This secret sauce² and the loyalty it has engendered have helped Apple carry on while a multitude of its once-competitors fell by the wayside. Remember Kaypro, Osborne, Northgate, Eagle, Columbia, ALR, AST, Cromemco, Sinclair, Commodore, Zenith, Franklin, Acorn, or Be?³ However, as a PC company, Apple finds itself in a shrinking niche.

For years, Apple has survived rather than truly thrived—though survival in itself is an accomplishment in personal computing, *especially* considering how different Apple's products are from everyone else's, and how much Macintosh's fundamental GUI differentiation has eroded in the last decade. Windows has slowly improved its ease-of-use while consolidating its market dominance. The Mac-Windows usability gap continues to shrink, though even XP may not quite equal Apple's elegantly integrated OS X. And Linux is beginning to compete for the relatively small number of desktops whose owners want to run something other than Windows—even if doing so means that they have far fewer software choices than their Microsofted brethren. Granted, IT contrarians and the anti-Microsoft crowd hardly make up a mass market, but they are a niche in which Apple has been popular. Worse, even among consumers, basic PCs have become commodities bought in large part on price, which never has been Apple's forte. Sure, a certain type of power user gets all revved up about case modding or how many frames per second some graphics board can handle trilinear filtering, no anti-aliasing, and anisotropy set to "1"—and is willing to pay significant extra for premium performance and features—but these people don't form a mass market, either.

1. To be sure, techie true believers partake in various software and hardware religious wars from time to time, but they're hardly the mainstream buyer. Apple's mainstream buyers, however, tend mostly to be true believers.
2. We would say "Apple sauce" but Apple already used that particularly bad pun when it came up with a name for the Apple III's operating system, Apple SOS.
3. If you don't remember, don't feel bad; most people don't. You'll just have to trust us that these were real and (for a while) viable PC companies.

If anything, Apple's long-term outlook for the enterprise includes even tougher challenges. True, it's made some neat product choices that help it in the near-term. OS X's Unix foundations coexist more peacefully with non-Mac systems than Apple's more provincial past offerings. And the Xserve is a nicely put-together, very manageable, high-density rackmount server that's found some takers in Macintosh-friendly environments like academia and research.⁴ But enterprise buyers tend to be system agnostics who are rarely enamored of any tech company just for sizzle and style. It's difficult to see what distinctive merits Apple can bring to bear that will convince bottom-line-oriented corporate folk that Apple deserves a place on their desktops and in their datacenters—given the additional cost of supporting yet another system type.

Apple may well be able to continue wringing some profit out of the modest number of IT departments who favor Apple gear—typically because they already own some and are used to it—for a while. And it should by all means endeavor to do so. But this isn't the path to continuing relevance, or even survival. The negative factors in the Apple equation are simply too great for any long-term optimism, and the waning religious fervor of its fan base is too weak to counter the triple whammy of Windows, Linux, and a strong trend toward commoditization.

So Apple has to change the equation. It needs to reorient itself toward a market in which its skills are more fully appreciated and relevant—one not dominated by opposing market forces over which Apple has no control.

Rather than continuing as a traditional computer company, consider Apple's potential as a creator of consumer electronics and associated services. Apple has already taken some steps in that direction with its iPod portable music player and its iTunes music download service, but it's still fundamentally a computer company. What if Apple were to shift its considerable design talents more fully toward a new generation of devices for playing music and video and games? Consumer electronics is, after all, a fast-developing area with far more examples of truly horrid user interfaces than superb (or even decent) ones. It's also a specialty area that converges with "computers" at many angles—even if the concept of a single monolithic device that brings together all entertainment and PC functions has turned out to be a chimera.⁵

What might products from a future Apple look like? Imagine, for example, an entertainment hub that was actually easy to use—one that can play digitized music, catalog CD's, record television programs, display photographs, and more. It doesn't replace a computer; rather it becomes the general-purpose device for the lean back/ten-foot viewing experience in the living room. It interacts cleanly with computers (not just other Macs, either) but it doesn't require them.

Can you build a functional media center in a living room today? Sure, but the devices tend to be hard to use or the functions are fragmented across multiple boxes that interact in a limited way, if at all. Perhaps there's a place

4. See Illuminata report "Apple's Server Biz: Building on Unix (Again)" (January 2003).

5. The failure of Apple and others to create a do-everything consumer IT device is partly a result of ignoring people's tendency to use devices in different ways in different places (e.g. "lay back" vs. "lean forward" interaction styles) and not appreciating that rapidly dropping price points would make multiple "computers" (of various types) per household eminently practical.

for both low-end all-in-one devices and high-end systems assembled from components. Think of it as the stereo system for the 21st century. One of the biggest challenges will be making the connections seamless and the user interface clean. Sounds like something at which Apple could do a pretty good job.

Of course, there's more than technology to such a transition. Apple would also have to make its manufacturing more efficient, optimize its mix of markets and products, and develop the right sales channels. It would certainly need to do some learning—and doubtless hire some specialized expertise. For example, today Apple kit tends to be more expensive—sometimes a lot more—than its Wintel counterparts. But mass market gizmo buyers are at least as price-conscious—often more so—than PC shoppers. After all, the purchase itself is likely completely discretionary—while buyers of work or school PCs have to pick up at least *some type* of computer. Yet a product like the iPod carries a premium compared to less regal MP3 players in the same way that Macintoshes usually do over Wintel brands. Apple needs to deal with its supply chain, distribution, manufacturing, and margin expectations in order to shift to pricing that is more in line with competitors.⁶

But the convergence of PCs and other types of consumer gadgetry would help Apple in a number of ways. For example, computers are no longer exclusively, or even primarily, sold through specialist computer retailers. They're right across from the stereo equipment in Best Buy, Circuit City, and even Wal-Mart. So a broader foray into products that fit more into the "home entertainment" product aisle than the "computer" ghetto no longer means a whole new set of distributors and retailers as it once would have.

Apple would certainly need to develop appropriate partnerships as part of any such shift. Acquisitions—even mergers—could be in the cards. However, given Apple's (and Steve Jobs') idiosyncratic identities and personalities, it's difficult to see Apple as part of some larger company. Trying to fit Steve Jobs into a management-by-consensus environment like Sony or Toshiba would be like trying to fit hiking boots on a mountain goat. However, if Apple decided to undertake a bold shift in focus on its own, it would have to figure out how to leverage its design juju with scientific mass-marketing, and somehow overcome the marketing and business hurdles that presently stand in its way. In fact, it would probably have to focus more on those issues that it would on technical or design questions.

Face it. Apple has lost the war for the general purpose desktop.⁷ Sure, it can (and probably should) continue to fight a rear-guard action—perhaps for many years to come. And its personal computer products might even have a place as a base station for a host of digital audio and other smart devices. Certainly it has nice computer products, such as its recently announced (and super-speedy) G5 desktop. But its market share in computers will

6. Even *enterprise servers* have trouble sustaining premium process—vis Sun's recent embrace of "low cost computing" to battle Dell. Features and other capabilities matter, but price has to be taken off the table first. See Illuminata report "The (Slow) Blending of Linux into Sun" (August 2003).
7. We pause here to listen for the outraged cries of the Macintosh faithful, who continue to ignore reality by claiming that Apple has a viable chance for long-term growth, rather than a slowly declining market share in a niche continually invaded by less expensive and increasingly elegant competitors. We regret this reality, but cannot deny it.

continue to shrink over time, the support of software developers will continue to wither, and its sales will consequently erode further in a vicious cycle. Apple can slow the cycle, but not stop it.

In many respects, Apple is already more like a consumer electronics company than a computer company. Apple maintains an enviably strong sense of design, significant customer loyalty, and a corporate obsession with improving the way people interact with its machines that's unique in the computer industry. All those factors make for a potentially great fit with an electronics-buying public far more influenced by brand name, ease-of-use, and general coolness than they are by either processor speed or total harmonic distortion curves. Hewlett-Packard, a company always known more as "worthy" than "interesting," has certainly discovered that, and has introduced more than 150 consumer-oriented products to form the core of an aggressive push to attract those consumers. But it doesn't have many of Apple's assets, either in style, or customer perception. Apple can't take those assets to the bank, but this company that Steve Jobs has transformed so many times could perhaps use them as the foundation for a new career.

