

Ole Eichhorn

From: Gerry Purdy - Inside Mobile and Wireless [insidemobile@frost.com]

Sent: Wednesday, December 16, 2009 1:16 PM

To: ole@pacbell.net

Subject: Why Android is Getting so much Traction: Think Less than Free



Trends in mobile and wireless technology.

Why Android is Getting so much Traction: Think Less than Free

December 16, 2009

Imagine you work for Samsung and you've scheduled meetings with the Microsoft folks to discuss your product roadmap for building Windows Mobile wireless handsets. The meeting goes well. The presentations are professional and end with Microsoft talking about "getting really aggressive in license fees" for Windows Mobile. They are willing to take up to a 20% discount on the license fee per unit. Very impressive. You report the meeting results to management.

Following the meeting with Microsoft, you have the folks from Google come in to discuss their plans for your building wireless handsets based on Android. Their presentation goes well and is also very professional. Both firms have excellent software developers. Both firms want to grow their market share.

But, a strange thing happens when the Android folks discuss business terms. They explain that they don't charge any license fee since they are an open-source environment. Rather, they are willing to have Samsung produce Android handsets at no charge. Free is a pretty good deal. Now, to be sure, if Android wasn't any good, free would be meaningless, but with rock-solid software, free is a very good deal.

The Samsung folks ask the Android representatives how is it possible for Google to offer Android free (via open source)? After all, you point out that it costs a lot of money to support a team of top-notch software developers to build Android. They have to cover those costs in some way.

The folks from Android explain that they get their revenue primarily from advertising-based Search, and consumers will be doing a lot of Google searches on Android phones.

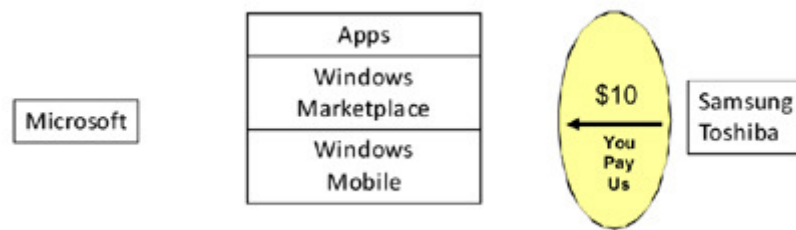
So, naturally, you respond with, "OK, I now see why you're able to provide Android for no license fee via open source." But, inside your head, you also think, "Geez, these guys are getting zillions of dollars from Search advertising, and all I get is a free ride by not having to pay a license fee like I would to Microsoft." The expression on your face clearly communicates concern and jealousy.

But wait (in true Billy Mays style), there's more. The Android folks smile. You don't say anything. It becomes deathly quiet in the room. After a long hesitation, someone on the Android team says, "You know, we really want to work with you guys. How about if we share some of our advertising-based Search revenue with you? Would that make it a deal?" Heart rates begin to rise. Salivation increases. A feast is about to begin. The meeting draws to a quick and positive conclusion with, "We have decided to work with Android. We see a very bright future working with you guys." You report the results of this meeting to management as well. Guess which arrangement gets approved?

Now, I don't have access to any of Google's business terms with those who build handsets on Android or any operator agreements, but I think this hypothetical story clearly suggests that Google is more attractive in which to deal than other mobile OS providers.

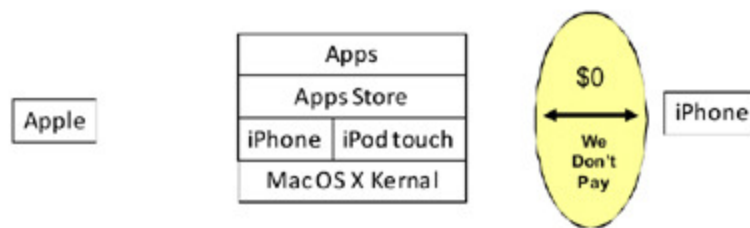
It's amazing how "less than free" sends a powerful message – having to pay someone (the Microsoft model) simply isn't as attractive as license-free and the ability to generate revenue from the use of the platform. Let me explain why.

First, Microsoft has a business model of a license fee for incorporating Windows Mobile into wireless handsets. They don't (yet anyway) have mobile advertising revenues that could offset the license fee. Take a look at the following diagram:



Clearly, the license fee approach results in handset manufacturers paying Microsoft a license fee for each unit sold, plus, typically, some other fees as well. (I'll be writing more on what I believe Microsoft should do in a future column.)

Now, let's take a look at Apple's business model when it comes to working with their in-house software group. Their business model looks like this:



Apple doesn't have to pay their software group anything to get good software because it's all part of the same company. Thus, their license fee is \$0. But Google goes even further and offers to pay the handset manufacturer to use their Android software:



As you can clearly see, the OS software license fees just went from fee-based (Microsoft) to free (Apple) to less than free (Android) in less than two years.

None of this would have mattered if Android wasn't a good software. Google gets to enjoy increased market share primarily because they are building software that provides an excellent user experience.

Because each version of Android can be customized by the operator and the handset manufacturer (provides differentiation), the Android platform ends up being closer to the way the iPhone is developed than the way Microsoft develops their single code base OS that is applied across all handset manufacturers and operators. This increases cost for maintaining multiple versions, but it more closely ties the software to the hardware. This is important in the highly mobile world of wireless handsets because a seamless user experience is an important quality in wireless handsets.

The next time you hear that HTC, Samsung and Motorola are bringing out another 30 Android handsets, you can rest assured that they all expect to generate device sale revenue when selling the handsets to the wireless operator, but they also expect to get some downstream revenue from Search and other sources. In addition, handset manufacturers like Samsung, HTC and Motorola are developing their own App Stores to provide additional sources of revenue. The handsets are becoming less important in the overall business model since there are now other sources of revenue to be had. The device designs, however, are still important.

On top of this, Google recently announced plans to acquire AdMob for \$750 million. Once approved, this could represent another source of revenue to share with partners. The story keeps getting better and better.

The dynamics of the entire wireless ecosystem are changing right in front of our eyes. More changes are on the way with the creation of service platforms and selling devices outside of the carrier (like Best Buy is doing today). I'll write about more of these paradigm shifts in 2010.

Written by:



J. Gerry Purdy, Ph.D.
VP & Chief Analyst
Mobile & Wireless
Frost & Sullivan
gerry.purdy@frost.com
404-406-5309

Disclosure Statement: From time to time, I may have a direct or indirect equity position in a company that is mentioned in this column. If that situation happens, I'll disclose it at that time.

If you would prefer not to receive further messages from this sender, please reply to this email and place the word REMOVE

in the subject line.