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The Decline of the Mid-Market Cell Phone

While the overall mobile-phone market is booming, mid-tier phones will face sharply declining sales in the next few years

by Jay Yarow

Standing on a New York subway platform, Brooke Hunter, a financial analyst at Bank of America, punches the keyboard of her Motorola Q with her thumbs. She used to own "some Samsung flip phone," she says, but bought a more sophisticated device because it gives her access to her e-mail. When her train arrives, she steps inside a car where four other people stare intently into their BlackBerrys.

It's a view into the future of mobile communications. Hunter and her fellow commuters increasingly are switching to more advanced devices, called "smartphones," that can handle e-mail, Web browsing, and more. At the same time, sales of simple, cheap mobile phones are booming, as Nokia ([NOK](#)) and other phonemakers move into emerging markets.

SQUEEZED BY THE HIGH AND LOW ENDS

What's surprising in this picture is the dismal fate awaiting mid-market cell phones. Even as the overall market surges, sales of mid-level phones are expected to crash in the next five years, according to [ABI Research](#). ABI anticipates that just 441 million such phones will be shipped in 2013, down from 854 million in 2007.

It's a reflection of the changes ahead for mobile phones. ABI calls these mid-tier devices "enhanced" phones because they have some capabilities beyond just voice calling but don't have the broad features of smartphones. Enhanced phones such as Motorola's ([MOT](#)) Razr 2 and the [LG](#) Voyager use closed operating systems, so new software can't be added to the devices. Smartphones run open operating systems, like Windows Mobile or Symbian, so users can load on new software applications from independent developers. As the market for such software has begun to grow, there's been a surge in new applications. Consumers today can use their phones to watch videos, catch up on Major League Baseball scores, or blog from pretty much anywhere.

"The mid-tier phones, which are the largest [segment] now, will be squeezed over next five to six years," says Kevin Burden, director of mobile devices at ABI. In 2007, mid-level phones represented 74% of the total units sold, while low-end phones represented 16% and smartphones 10%. In 2013, ABI sees those shifting drastically: Mid-tier phones are expected to account for 23% of sales, while low-end phones would be 46% and smartphones 31%.

SHIFTS IN VOLUME

Burden believes smartphones will grow in popularity as they decline in price, due in large part to companies like Nokia and Google ([GOOG](#)) developing free operating systems for mobile phones. The closed operating systems that run enhanced phones are typically built internally by phonemakers. Using open systems that are free saves money and gives customers access to a greater selection of applications, which aids carriers because they get more revenues when subscribers sign up for data plans to browse the Net. Tina Teng, a wireless communications analyst with researcher [iSuppli](#) says the Windows Mobile operating system costs between \$8 and \$15 per unit. Symbian licenses, which Nokia intends to make free, presently cost \$5 per unit on average.

While free mobile operating systems save just a small amount on a per unit basis, they have a more substantial effect on lowering internal development costs. "If companies adopt free software, it will save them some headaches. They can put their developing efforts into other areas," says Teng. "When software is free, companies can concentrate on what software they should incorporate into their devices to differentiate themselves to the consumers."

A rise in low-end users and a drop in mid-level users could radically alter revenues for some companies. "The volumes from developing markets will be immense in years to come, but the revenue will be miniscule," says ABI's Burden. "It could be 40% of the market in five years [in units], but it's going to generate less than 10% of the revenues." Burden expects most major handset manufacturers to change their product development in anticipation of these changes, but he cautions there could be trouble for companies that don't adapt. "They need to evolve their product portfolios," he says.

GETTING SMARTER

Nokia is already gearing up. The Finnish company, which is the largest maker of mobile phones in the world, is busily developing phones to meet both high- and low-end demand. Its most advanced phones let people play music, take videos, manage their e-mail, and navigate through foreign cities with street-by-street guides. "Ten years ago, people used mobiles for voice," says Bill Plummer, vice-president at Nokia Americas. "Today they use them for any passion."

Not everyone believes in the decline of the mid-market cell phone. Japan's Kyocera ([KYO](#)), for example, plans to continue targeting customers looking for mid-tier phones at the same time it offers more affordable cell phones. John Chier, director of corporate communications, says the company was an early entrant into the smartphone market, but shifted its focus to the faster-growing mid-tier market several years ago. While declining to specify Kyocera's future business strategy, he says there's a natural evolution in the market as the features of smartphones become common in midrange phones, and the lower prices on such phones attract a broader group of customers.

[Verizon Wireless](#) is also taking a nuanced approach. The company, a joint venture between Verizon Communications ([VZ](#)) and Vodafone ([VOD](#)), plans to offer its customers plenty of high-end smartphones, but it will also let them choose phones with fewer features—and lower price tags. "Customers will have many choices," says Wanda Newman, marketing manager at Verizon Wireless.

Still, once people have the experience of holding a small device in their hand with all the capabilities of a computer, it's tough to accept something less. Brooke Hunter says she's hooked on the Motorola smartphone that lets her zip off e-mails whenever she has a spare moment on the train. "I'm used to typing on the keyboard," she says. "I would never go back to a flip phone."

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