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TECHNOLOGY July 25, 2007, 12:01AM EST

The New Wireless Playing Field

Cell-phone makers and outsiders like Google want to break free from carriers' rigid controls and gain direct access to subscribers

by [Olga Kharif](#)

Back in the 1980s, when Americans were buying the first brick-size cell phones, service providers quickly came to dominate the playing field with barely a struggle. Sure, there was a role for other companies, including the makers of those hefty handsets. But thanks to a government that doled out airwave licenses with few strings attached, the real power in the U.S. mobile-phone industry lay with Ma Bell and her powerful offspring. It was they that built out the networks, collected monthly bills and set the terms of use for the country's millions of cell-phone users.

Motorola ([MOT](#)), which invented much of the initial cellular technology, was fairly happy just to have a new market for its wireless equipment. And far away in Finland, a small manufacturer named Nokia ([NOK](#)) was known for making everything from paper to bicycle tires—everything except phones, that is.

That early tilt in the balance of power has enabled the wireless carriers to hold sway ever since in just about every aspect of the business, from the very design of cell phones to dictating which Web sites and what videos users can view on those handsets.

But two decades later, a wide array of troops are massing against this system—from Apple ([AAPL](#)) and Nokia to industry newcomers like Google ([GOOG](#))—all intent on wresting control from the carriers to deal directly with mobile users and grab a bigger share of the revenue.

BREAKING DOWN BARRIERS

The dominant service providers like AT&T ([I](#)) and Verizon Wireless ([VZ](#), [VOD](#)) remain in firm control for now, and offer no apologies for carefully protecting their profits as payback for the billions they've spent on building their networks. But an upcoming government auction to use new swaths of the airwaves could favor industry newcomers and require winners to open their networks to any device, service or technology from rival providers.

Google in particular, frustrated by the endless hurdles for getting its search engine and other services on cell phones, has been urging the Federal Communications Commission to impose such conditions, pledging to bid big in the auction. And while the final rules have yet to be decided, FCC Chairman Kevin Martin has publicly embraced at least some of the proposals to ensure the new airwaves are less rigidly controlled by the winning bidders. This potential new freedom for users to buy ringtones, video games or even their actual calling plans from any provider could drive the sort of innovation

that's common on the Internet, but exceedingly rare on the mobile manifestation of the Web.

APPLE'S MODEL

For a taste of what this new dynamic might look like—and the market's obvious pent-up demand for it—one need look no further than the iPhone. Apple succeeded in wresting an unprecedented amount of control from carrier partner AT&T in designing the device, picking the applications and determining how to price the device and service. In fact, thanks to the fanatical customer base it was sure to bring AT&T's way, Apple also negotiated to win a rare share of the carrier's monthly subscriber fees.

Though some complain Apple itself copied the carrier playbook by making it hard for anyone else to create applications for the iPhone, it's hard to argue with the results: [RBC Capital Markets](#) estimates that by July 25, when Apple reports its quarterly earnings, up to 1.5 million iPhones will have been sold at \$499 or \$599 a piece. As many as half of these buyers likely switched to AT&T service from another carrier specifically because of the device, figures Neil Strother, an analyst with [JupiterResearch](#).

The iPhone also provides proof of the burgeoning demand for mobile freedom in the way of so-called unlocked mobile devices. Such phones, common in Europe but rare in the U.S., can be purchased separately from a customer's wireless carrier, but used on that provider's network. At present, eBay's ([EBAY](#)) auction site lists several unlocked iPhones where the block on connecting the device to a Wi-Fi network without an AT&T cellular contract has been disabled. These unlocked iPhones are selling for as much as \$800—a 33% premium to the list price.

"OPENNESS AND FREEDOM"

Nokia is pursuing the unlocked device market with increasing vigor, as well as other initiatives that appear likely to fuel friction with U.S. carriers over the coming years. The company recently began selling several of its high-end mobile devices through the Web sites of computer makers Dell ([DELL](#)) and Gateway ([GTW](#)), as well as other online retailers. And at the flagship stores Nokia has opened in the U.S. over the past year, there's been a significant increase in sales of unlocked devices, reports Nokia Vice-President Bill Plummer.

Similarly, online retailer PureMobile says it's been selling thousands of unlocked devices to North American consumers each month, tripling the company's revenues in the past year. This growing demand suggests carriers eventually may need to fork over extra cash for cell-phone makers to "lock" their wares if they hope to retain the current business model, says Michael Mahoney, senior managing director at investment manager [Falcon Point Capital](#).

Nokia, which plans to create a new unit in January to support its increased emphasis on software and services, is also working to offer its own music, multimedia, and navigation services directly to end users. The company has made several acquisitions to pursue these plans, including a July 24 deal to buy Twango, an online photo and video-sharing Web site. "There's something very powerful taking place in the wireless market today," Nokia's Plummer says. "It's about the coming together of the Internet and mobility and consumer expectations. It's about openness and freedom."

MUCH CHEAPER SERVICE POSSIBLE

And then there's Google, which has made no secret of its mobile aspirations. The Internet powerhouse said on July 20 it might bid \$4.6 billion for the wireless airwaves to be auctioned off in early 2008. If it wins, Google could build an alternative wholesale network on which multiple providers could offer free or cheap wireless service to users who agree to view Google ads and content, says Rich Nespola, CEO of consultancy TMNG Global ([TMNG](#)), where Google is a client (see [BusinessWeek.com](#), 7/20/07, "[Google May Bid Billions on Wireless](#)"). The success of ad-supported offerings on the Internet suggests there are plenty of consumers who'd put up with ads if it means getting rid of that monthly cell bill of \$50 or more.

Another wildcard threatening the cellular status quo is the proliferation of alternative wireless networks based on Wi-Fi and a longer-range related technology called WiMAX. "We see these [Wi-Fi] networks as being potentially very disruptive," says Stefan Weitz, director of planning for MSN at Microsoft ([MSFT](#)). On July 19, Microsoft announced it will serve up content and ads via Wi-Fi networks through a mobile marketing firm named [JiWire](#). If the ad-supported approach succeeds, Wi-Fi network operators may drop the subscription fees for public hotspots offered by retailers and a growing number of cities. While Internet calling via Wi-Fi is hardly as convenient as using a cell phone, a free alternative might also stoke impatience with a monthly cell bill.

FEWER FEES

Carrier revenues from their cellular data networks, which have cost billions to upgrade, are threatened as well. Already, with the iPhone tied to the iTunes service, Apple has emerged as a mighty force in mobile content. And because the iPhone can connect to any provider's Wi-Fi network, Apple may eventually be able to push other applications and services onto subscribers' handsets without asking for AT&T's permission, suggests Richard Doherty, director of consultancy the Envisioneering Group. "The playing field has been changed," he says.

Other software and service providers are already charging users directly. [Jajah](#), a provider of a Web-based phone calls, offers a cell-phone application that lets consumers avoid the astronomic fees that mobile carriers charge for dialing overseas numbers. The company says its customer base has doubled to 2 million users between November and March, with a third of them located in the U.S. Similarly, [Sling Media](#) allows consumers to bypass carrier charges for video content by enabling them to watch their home cable TV channels on high-end mobile phones.

"I don't see the carriers' walled garden lasting long-term," says Kevin Rose, founder of [Digg.com](#), which recently launched a mobile version of its popular news aggregation site. "More and more people are going to demand the noncensored version of the Web."

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