

## **Apple's endless expanding app universe**

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*In 2008, Steve Jobs said, 'Let there be apps.' Now a cosmos full of companies and developers is bound by the laws of Apple—for better and worse.*

Five days after the product launch of the decade—we're talking about the iPad if you hadn't guessed—Steve Jobs was fielding questions at a press conference on Apple's (AAPL) Cupertino (Calif.) campus. The iPad release had been a stadium-style show, full of stagecraft and choreography meant to wow a global audience. The follow-up was more like a club gig for the truly devoted. The purpose was to show off some improvements to the software that powers the iPad, as well as the iPhone and the iPod touch. Surrounded by journalists and bloggers as interested in the guts of his creation as its flawless skin, Jobs, still gaunt from a cancer-related liver transplant about a year ago, was loose and commanding, his energy and wit at full force. Asked why Apple hadn't yet included the ability to run small, portable chunks of code called Widgets on the iPad, he grinned. "We only shipped it on Saturday," Jobs said. "And on Sunday we rested."

It was a joke, of sorts. Apple is not divine—though anyone who rode the stock from \$3 to \$247 since Jobs' 1997 return to the company might disagree. What Apple has come to resemble is an endlessly expanding cosmos. More than 85 million iPhones and iPod touches are in existence, up from zero in July 2007. iPhone users have downloaded 4 billion apps from Apple's App Store, and more than 10 billion songs, 33 million movies, and 250 million TV shows from iTunes. iPhone owners, who make up just 2.2% of total mobile-phone consumers worldwide, according to market research firm IDC, chug 64% of all mobile browsing minutes, says Net Applications, another research firm. According to Apple, 500,000 iPads have already been sold, increasing the number of people who have access to a rich life, full of endless media and communication options, without ever leaving the Apple platform.

Apple's neatest trick is that this platform would expand even if Apple were sitting still (it's not). Forget Apple's 34,000 salaried employees. More than 125,000 developers now work to make apps for Apple products. Apple pays them nothing. They sign contracts agreeing to Apple's rigorous terms in the hope that users will buy their apps or view ads on them. In the hope, really, of becoming another little planet orbiting Apple's sun—with the truly lucky ones landing a spot in the company's TV spots.

In the quarter ended Mar. 31, the company blew past analysts estimates with sales growth of 49%, to \$13.5 billion, while profits soared by 90%, to \$3.07 billion. That included record sales of the iPhone, up 131% from the previous year. Jobs even broke from his typically tight script to note: "We have several more extraordinary products in the pipeline for this year." That could be because a midlevel engineer celebrating a birthday left a prototype of an upcoming iPhone model in a bar on Apr. 18, stealing the element of surprise. Still, there's little doubt Apple remains on the march into new markets, creating even more of a reason for developers to hitch their wagon to Apple.

For Apple, it's a Wintel-like cycle in which new Apple hardware drives the creation and purchase of new apps. Except it's better than Wintel; the combination of Intel processor running Microsoft's Windows operating system never really managed to leap from PCs to other devices. Apple has constructed its empire so that almost anything you buy on iTunes—and Apple has your credit-card information with your first purchase—can run on any future iProduct. "The laws of nature say that [Apple is] making too much damn money, that this has to be unsustainable," says David J. Eiswert, who runs T. Rowe Price's (TROW) \$312 million Global Technology Fund (PRGTX). "But who is going to stop them?"

Plenty of companies fancy themselves contenders, including Microsoft (MSFT), Nokia (NOK), Research In Motion (RIMM), and Google (GOOG). All have certain competitive advantages. RIM continues to be the choice of the e-mail-addicted, while Google's search profits allow it to fund free Android software, and possibly free mobile hardware in the future. Yet Apple's head start in apps may be too great to overcome. More than 185,000 apps are available in the App store, compared with 38,000 in Google's online store for its Android mobile software platform. Thirty-five thousand new iPhone apps have been produced since February, even as many developers have been working on offerings for the iPad. "That's a lot of developer attention that's not going to Android," notes Bart Decrem, CEO of Tapulous, which makes music-themed iPhone games that are played by 8 million iPhone owners every month.

That means Apple's future growth is as much a matter of managing its collaborators as beating its competitors. At a public interview in 2007, in which he shared the stage with Bill Gates, Jobs noted that in its early days, Microsoft was much better at forging partnerships than Apple. "I think if Apple could have had a little more of that in its DNA, it would have served it extremely well," said Jobs. "I don't think Apple learned that until, you know, a few decades later."

How well Apple has learned the lesson is evident in the ways it has encouraged app development. Developers keep 70% of the retail price of each app sold by Apple. This summer, Apple will roll out iAd, a mobile advertising platform that lets advertisers make inventive messages appear inside apps. Developers will keep 60% of the revenue.

Strings are attached, however. In the fine print of the new developer contract are strictures that could hurt or even kill many developers' plans. Apple has always banned apps built with Adobe's (ADBE) Flash technology because it views Flash, the program that animates some 75% of video on the Web, as buggy and battery-draining. While many software experts agree, it's also true that banning Flash means that apps developed for the iPhone won't work with non-Apple devices. The new contract takes Apple's war on Flash even further: Apple outlaws any software that translates Flash-based apps into iPhone-approved ones. "Apple has gotten better at working with developers the same way a chess master gets better at playing with pawns," says David Howell, CEO of iPhone app maker Avatron Software.

The tougher terms for developers could also hurt companies that make money through data gathered from iPhone users. Because Apple knows so much about users—from what songs they like to where they are at any time, thanks to GPS—its devices present a unique opportunity for targeted ads. At the moment, ad network operators worry Apple may soon decide it wants to keep that data to itself. "We don't believe we're affected by the new rules, but man, they're volatile," says Wade Beaver, CEO of DoApp, a small app developer in Rochester, Minn. "It makes me wonder whether I want to build my business around a company that could decide to change its business model at any time. That could put me out of business."

Google would be one of the biggest losers if Apple continues to raise the wall around its garden. The search giant snapped up mobile advertising market leader AdMob last fall for \$750 million when Apple mistakenly let a no-compete period lapse on its own roughly \$600 million AdMob bid, says a source with knowledge of the deal. Google CEO Eric Schmidt was so intent on buying AdMob that two people with knowledge of the deal say he agreed to pay a "kill fee" of around \$700 million if the deal failed to close for some reason, such as an antitrust motion from the Justice Dept. Google spokeswoman Jane Penner declined to comment on the terms of the deal.

Apple claims these policy changes aren't meant to hurt competitors, just help consumers. Jobs argues that avoiding Flash and refusing to let outside ad networks gather user data are moves that protect his customers. Yet Apple's omnipotence—and the lack of an obvious structural monopoly à la Windows that would invite regulation—leaves the Apple universe subject to the whims of its creators.

Jobs proudly notes that Apple sells no porn-related apps through the App Store. Yet political cartoonist Mark Fiore had his app rejected last December based on a clause against apps that "ridicule" public figures. The case became a cause célèbre after Fiore won a Pulitzer Prize on Apr. 12. Two days later, Fiore got what he says was a sheepish call from an Apple staffer, and on Apr. 20 his app showed up on the App Store. "But how many people are doing good satire out there and getting rejected?" says Fiore. "The only reason they're talking to me is because I'm in the middle of my 15 minutes of fame."

Despite his misgivings, Fiore resubmitted his application. Such is the lure of Apple's market power. Developers, many of them tiny startups, can write a single version of their app and reach the roughly 100 million Apple customers. On other platforms, they would need to create dozens of versions to work properly on dozens of less popular devices, each with different screen sizes and keyboards. Currently, 60 devices work with Google's Android software, and dozens more are in the works, says analyst Kevin Restivo of IDC. That makes Google's perceived advantage—a bounty of Android hardware—a weakness in the eyes of many developers. "So far we've decided it would take more time to port an app to another platform than it would be to just write a new app for the iPhone," says Avatron's Howell. Avatron's app, designed to transmit work files wirelessly between a PC and Apple's devices, has brought in \$1.5 million in revenue since its 2008 release. That's enough for Howell to pay his seven employees a Silicon Valley living wage. On the other hand, he says, "I haven't heard about any Android success stories." Google spokesman Anthony House says, "We don't track the success of individual Android developers, but we're extremely happy with the breadth and quality of the apps available in Android Market."

For all the restrictions, most developers feel that obeisance to the laws of the Apple cosmos is worth it. For years, San Francisco's Zinio has made digitized copies of 2,400 magazines available on its Web site. Once iPad owners began busily playing with slick, touch-controlled versions of such publications as The New York Times and USA Today, it was a natural next step to get Zinio's iPad app. By Apr. 11, Zinio's reader temporarily spiked to become the fourth most popular free iPad app. That led to a 300% increase in revenue from the pre-iPad era. And making the app, says Richard Maggiotto, Zinio's CEO, was easy. "The back-end stuff the developer sees is as well done as the products the consumer sees," he says.

That may be Apple's greatest advantage. In order to develop products just as he wants them, Jobs has shown a willingness to do more than his rivals. PC makers such as Dell (DELL) and Hewlett-Packard (HPO) are powered by Intel (INTC) and run Windows by Microsoft; neither has shown interest in the costly job of building unique operating systems or designing its own chips. Apple does both. Microsoft and Google have only recently decided to design their own mobile devices, and in most cases they're purchasing "white label" hardware from other manufacturers and branding it as their own. The iPad's 10-hour battery life is a result of Apple's ability to have its chip, software, and industrial designers work together to limit unneeded power use.

All this eases the tech-buying public down the path toward Apple; iPhone's smartphone market share is currently 25.4%, according to comScore. And as long as the company exerts a gravitational pull on consumers—and manages to balance the rewards to developers with pushing them around—the apps will just keep coming. "How willing you are to expose yourself

to that relationship is directly related to how much revenue you can make," says DoApps CEO Beaver. "You'll take a lot, if you're making a lot of money."

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