

Palm's Overhaul: Thumbs Up or Thumbs Down?

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It is often said that those who forget history are doomed to repeat it. Worse still is applying the right lessons of history to the wrong problems, thereby making fresh mistakes. We worry that personal digital assistant (PDA) pioneer Palm's recent reorganization may lead it directly into this trap. By learning the wrong lessons from Apple Computer's failure to split itself into two operating divisions in the 1980s, Palm is setting itself up for a different kind of failure today.

This past October, Palm completed a major overhaul. It finished the acquisition of leading rival Handspring and divided itself into a device company (palmOne) and a software company (PalmSource).

Palm seems determined not to follow in Apple's path. During the 1980s, Apple chose to keep its Macintosh computer closed and proprietary rather than sell its innovative operating system to other computer manufacturers.

Though most aficionados considered Apple's operating system superior to Microsoft's, the open, modular architecture of computers assembled by manufacturers such as IBM, Compaq, Dell, and Gateway conquered the market, and subsystem supplier Microsoft (along with microprocessor manufacturer Intel) ended up capturing just about all of the value in the computer industry.

Many believe that if Apple had dis-integrated, it—not Microsoft—would have a market capitalization of close to \$275 billion now, rather than its current \$7.5 billion.

The value chain integration theory affirms this view. The theory states that when the functionality of a product is not good enough for a particular application, interdependent, proprietary architectures win. When the functionality and reliability are good enough for a particular application, then modular, open architectures win.

So Apple's strategy was first right, and then wrong. When the personal computer could not adequately perform simple tasks such as word processing, Apple's proprietary system made it a market leader. However, when the personal computer became good enough for simple tasks, Apple should have offered its operating system to modular assemblers.

Does Palm's move position PalmSource, its software company, to succeed where Apple failed? Though the question is complicated, in the final analysis, we think not.

At first glance, in the volume tiers of the market where PalmSource's potential growth would be biggest, current PDA performance is "good enough" for most users. Therefore, in these market layers, this move makes sense. Palm had already standardized interfaces between the hardware and the software. One would therefore think that PalmSource will be able to focus

on improving the performance of its software offerings on a variety of hardware configurations.

But the volume tiers of the market are declining. In the most-demanding market tiers that hold the key to future growth, products are still not good enough. This means companies that produce so-called smart devices that feature a variety of functions that go beyond scheduling and record keeping either need to interdependently design the entire device (à la Research in Motion's BlackBerry) or customize available operating systems to meet the specific needs of their particular device. These devices are not configured to support the operating system; rather, the operating system is configured to support the device.

This means that the hand-held device industry is in a fundamentally different circumstance than the personal computer world was in the 1980s. Then, most personal computers were modular, with the microprocessor and the operating system determining performance. In contrast, high-end PDAs still require complicated integration work, making integration a source of real competitive advantage. Therefore, prescriptions appropriate to the computer world in the 1980s are inappropriate to the PDA world in 2003.

What does this mean for Palm's offspring? As a standalone operating system provider, PalmSource is unlikely to be in a position to capture a disproportionate share of industry value in the tiers of the market that have the highest growth potential, because the device manufacturers will be the ones solving the problems that matter most to consumers.

Even worse, palmOne, the newly created device company, might face trouble in the most demanding market tiers. Competitors such as Samsung, Nokia, and Sony-Ericsson have set their eyes on the so-called smartphone market. Improving hand-held devices to better serve demanding customers is highly sustaining to these companies. Without the ability to interdependently design device and software, palmOne might find it hard to compete with these deep-pocketed competitors.

With 20/20 hindsight, it is easy to see that Apple should have opened up its proprietary architecture in the mid-1980s. Looking at the future through the lens of innovation theory, it is not at all clear that following this lesson is the right course for Palm.

Further Reading:

For more information on getting the scope of your business right and avoiding commoditization, see chapters 5 and 6 of *The Innovator's Solution: Creating and Sustaining Successful Growth* (Harvard Business School Press, 2003), by Clayton M. Christensen and Michael E. Raynor; also see the November–December issue of *Strategy & Innovation*