

Issues faced by Apple Inc in smart phones industry

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Abstract

Purpose: This case suggests the development of financial reporting of Apple Inc. in comparison with the industry over the period of 2004 to 2013. This study is helpful for different field of researchers e.g., management, technology, etc. Apple Inc. was found in 1976 by Steve Jobs. In 2007, Apple introduced smart phones and iOS and was the pioneer in this industry. But after the rising competition in this industry Androids snatched the market share from the Apple.

Methodology: This study illustrates the reasons and the current performance of the company in the industry. The performance has been measured through actual financial data and through various financial techniques.

Findings: This study has found that the company is losing share in the market because of the features in its products whereas the features offered by other competitors are relative consumer friendly and according to their demand.

Suggestions: To retain the market share Apple should offer more products that are more affordable for the consumers.

Keywords: Apple Inc, Samsung, Smartphone industry, financial ratio analysis.

1. Introduction

Apple Incorporation was formed in 1976 as a computer company by Steve Jobs. However, in the past decade, Apple has grown into a very complicated business unit that is more than just a computer business. Apple after launching its iPod became the market leader in the music players. Yoffie and Rossano in 2012 mentioned that, Apple Inc. entered in the phone industry in 2007 and launched the first iPhone that was followed with a big success. As Apple lies in consumer electronics industry so to evaluate the value of the company requires a good understanding with consumers and its products. As Apple has diversified its business therefore it is difficult for it to compete in all segments. The sole distinguishing thing about Apple is that it has a very strong customer base, which is the main thing in understanding the company.

Segment analysis:

The main business of Apple Inc. is designing, production and the marketing of the mobile communication and other media devices, computers and digital and portable music players, the company also sells a variety of software that are related to their products, solutions of networking and digital content. Basically the products and services of the company includes iPhone®, iPad®, Mac®, iPod®, Apple TV®, a portfolio of consumer and professional software applications, the iOS and OS X® operating systems, iCloud®, and a variety of accessory, service and support offerings as mentioned by Yoffie and Rossano (2012). **iPhone** is the Company's line of smart phones that combines a phone, music player, and internet device in one product, and is based on Apple's iOS Multi-Touch™ operating system. **iPad** and iPad mini™ are the Company's line of multi-purpose tablets based on Apple's iOS Multi-Touch operating system. iPad has an integrated photo and video camera and photo library app, and on qualifying devices, also includes Siri. iPad works with the iTunes Store, the iBooks Store, and the App Store for purchasing and playing music, movies, TV shows, podcasts, books, and apps. This segment contributes 53.5% in total sales. **Mac** is the Company's line of desktop and portable personal computers. Macs feature Intel microprocessors, the OS X operating system and include Mail, Safari web browser, Messages, Calendars, Reminders, Contacts and the iLife® suite of software apps. This segment contributes 18.7%. The Company's **iPod** line of portable digital music and media players

includes iPod touch, iPod nano®, iPod shuffle® and iPod classic®. This segment contributes 12.5%. **iTunes** is integrated with the iTunes Store, the App Store and the iBooks Store. The iTunes Store facilitates the users to buy and download music and TV shows and to buy or rent movies. The iTunes Store also includes hundreds of thousands of free Podcasts on a multitude of subjects. This segment contributes 2.58%. **Accessories** including Final Cut Pro, Logic Studio, Logic Pro, and its FileMaker Pro database software. Apple also produces Apple LED Cinema Display and Thunderbolt Display. This segment contributes 3.33% in total sales of 2013. (Apple, Inc., 2013, p.73)

Condensed Statement of Financial Performance 2009 to 2013

Particulars	2009	2010	2011	2012	2013
Revenues	42905	65225	108249	156508	170910
Net Earnings	8235	14013	25922	41733	37037
Total Assets	53,851	75,183	116,371	176,064	207,000

(Note: Above mentioned figures are in millions Dollar)

Source: (Apple, Inc., 2013, p.73)

2. Industry Analysis

The consumer electronics industry includes the production, supply and the trade of entertainment and communication device. These devices may include video camera, telephone, MP3 Players, DVDs and televisions. (Yoffie and Rossano, 2012)

Market Outlook:

In the Consumer Electronics Report 2013, it is said that the technology producers keep focus on advancement in next creation technology to meet customer demand. The industry will gain some comfort as the economy becomes more positive, seeing customers less hesitant to get rid of increasing non reusable income. Smart phones will keep increase industry growth, and connection will increase as customers seek to link up home and mobile apps and gadgets. Growing dependency on the web in business and personal areas is making close connections with emails providers vital.

Consumer Electronics Industry:

In Consumer Electronics (CE) Industry Outlook Report 2013 published by Euler Hermes it is mentioned that the revenues for the CE industry are expected to grow 2.4% in 2014 that would reach a record of US\$208bn sales. The latest evolving product categories (Bluetooth wireless speakers, convertible computers, 3D printers, health and fitness devices, wearables and Ultra HD television displays) will proceed by 107% year over year in 2014. The mentioned categories in technology are collectively projected to contribute more than

US\$6bn to the CE industry in 2014. Meanwhile today these evolving products show less than 3% of overall industry, but they are bringing 6% of all the industry revenue in quantitative terms. (Consumer Electronics Association, 2014)

According to the Quarter 4 2013 results, the average income grew by 20% Quarter over Quarter. Apple Inc. brought the growth of 53.7% QoQ, Sony Corp 27% and Philips 25.5%. On successive basis, the overall growth margins were improved by Apple and Phillips. The combined shipments of the devices such as computers, tablets, laptops and mobile phones, worldwide, would expected to reach 2.5 billion units in 2014 that would show an increase of 7.6% as compared to 2013. The device market is continuously flourishing, as the buyers are focusing on the best combination of the devices that can meet their demands and need. Users are rapidly moving from the desktop PC towards the tablets, hybrids and smart phones due to the flexibility and movability. (Gartner, 2014)

Apple's financial results for its Q1'14 ending December 2013 were quite positive with revenue of US\$57.6bn and quarterly net profit of US\$13.1bn. These results compare to revenue of US\$54.5bn and net profit of US\$13.1bn in the year-ago quarter. Gross margin declined to 37.9% compared to 38.6% YoY. International sales accounted for 63% of the quarter's revenue. (pwc.com, 2014)

3. Financial Ratio Analysis

The financial ratio analysis of Apple Inc is discussed here under:

The current ratio and the quick ratios of Apple are more than the industry average showing more stable short term liquidity position the difference both the ratios is less in Apple and more in the industry, showing that the inventory stock for Apple is relatively low. Furthermore the trend of these ratios for the last 10 years showing an overall declining pattern. On the other hand the debt to equity ratio was relatively very high in 2007 to 2009 as at that time Apple was busy in products development, meanwhile the industry ratio is less than the company, showing that Apple although has less debt to equity ratio from the past but still it is more than the industry averages and the company still relies on debt more from the industry. Inventory turnover ratio shows an increasing trend and in 2012 it was highest, this means that the company is working efficiently and it converts the inventory into finished goods 83 times while the industry average is approximately 45 times.

Table 1: Apple's Time Series Analysis

Year	Current Ratio	Quick Asset Ratio	Debt Equity Ratio	Inventory Turnover	Earnings Per Share	Net Profit Margin	Price Earnings Ratio	Return on Equity	Return on Asset
2013	1.678	1.638	0.675	83.44	40.03	21.67	12.75	0.299	0.505
2012	1.495	1.475	0.489	112.12	44.64	26.66	13.42	0.353	0.723
2011	1.608	1.580	0.518	70.53	28.05	23.94	14.36	0.338	0.576
2010	2.011	1.960	0.573	52.51	15.41	21.48	20.15	0.293	0.336
2009	1.880	1.857	0.934	53.28	9.22	19.19	31.17	0.295	0.227
2008	2.461	2.425	0.881	56.82	5.48	16.32	-	0.290	0.176
2007	2.361	2.323	0.744	51.46	4.04	14.56	-	0.240	0.159
2006	2.242	2.200	0.723	63.06	2.36	10.29	-	0.199	0.137
2005	2.956	2.909	0.547	74.35	1.65	9.53	-	0.177	0.128
2004	2.632	2.594	0.585	76.68	0.37	3.33	-	0.054	0.039

EPS and Net Profit Margin shows an increasing trend as Apple is generating more profit after launching iOS in the market, these ratios were high in 2012 but 2013 it shows some decline, yet these are more than industry average. The reason might be the launching of the Galaxy series and Androids with more features that has affected the sales of iPhones. ROE and ROA also shows the similar trend as mentioned earlier, the return has declined in 2013 but both are more than the industry averages. Asset turnover is almost similar as that of industry. (Apple, Inc., 2013, p.73)

Table 2: Apple's Industry Analysis

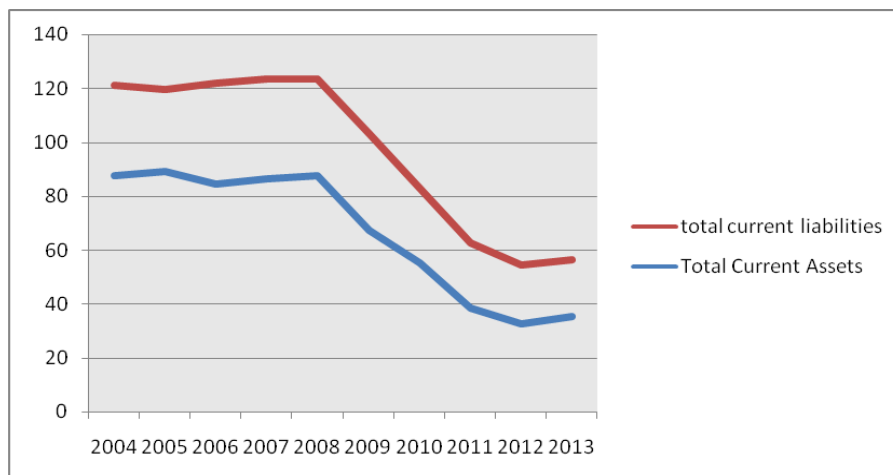
RATIOS	Apple Inc`	Industry
Current ratio	1.678	1.48
Quick ratio	1.638	1.20
Debt/ Equity Ratio	0.675	0.13
Inventory Turnover Ratio	83.44	45.14
Net Profit Margin	21.67	20.65
Price/Earnings Ratio	12.75	33.14
Return on Equity	0.299	0.275
Return on Asset	0.505	0.169
Asset Turnover	0.83	0.82

Here we can conclude that after introducing iOS in the market the profitability rises as well as the company had relied more on debt to operate efficiently in the market. But when androids have captured the market then in 2013 the profitability as well as market share is affected. (Nirav Patel, 2013)

4. Common Size Analysis/Vertical Analysis

Short Term Liquidity:

Apple's short term liquidity position was relatively weaker from 2007 to 2010 and the possible reason would be that Apple Inc. launched its innovative products in this period and pioneered the smart phone industry. Same trend was found in the long term liquidity position as Apple was in a high need of funds because of launching iOS.



Capital Structure:

Apple is the company that has a strong capital structure. The capital structure remained same all over the years (i.e. about 35:65) except in 2007 to 2010 due to the same reason that Apple was facing high need of funds due to research and development the capital structure in this period reached near 50% Debt and 50% Equity. In current scenario its statements show that it has almost 38% Debt in its total equity, means that the company has very little long and short term obligations, and a little threat that the company will face debt issues during an uncertainty.

Debt Structure:

In the debt structure the portion of the current liabilities is more showing that company is less vulnerable to risk.

Efficiency and Profitability

In 2004 direct expenses relative to sales were a major part and comprised 72% of the net sales while this trend was declining in the coming years, this shows that per unit product cost is decreasing and the company's internal operations are going more efficient and therefore the gross profit is showing an upward trend. It might be due to the Apple's innovation in smart phone industry by launching iOS (i.e. iPhone, iPad, etc) this gave it a boost in sales.

Same trend was observed in operating expenses and operating profits and all was due to the efficiency in the operations. Meanwhile the Net income relative to sales shows continuous growth but in 2013 it declined a little due to the people's preference of Androids over iPhone as mentioned by Tony Bradley, 2013.

Operating Management:

The various ratios and other discussed segments of financial statements show that the company is working very efficiently and its operations are working in an effective manner that the company is in profit from last many years.

5. Horizontal Analysis

In horizontal analysis of Apple, current assets and current liabilities changed positively but doesn't follow a specific trend and in 2013 the relative increase was lower, the reason behind this might be the shipment of the products are going down. Similar change was found in long term financial position.

The percent change in net income was 70% in 2010, 84% in 2011, but suddenly in 2012 in 60% and recently in 2013 is -11%, the reason mentioned by Derek Thompson in 2013 that it might be due to same as discussed earlier that Androids are taking market share from iOS. The sales of Apple are affecting due to Androids operations in the market.

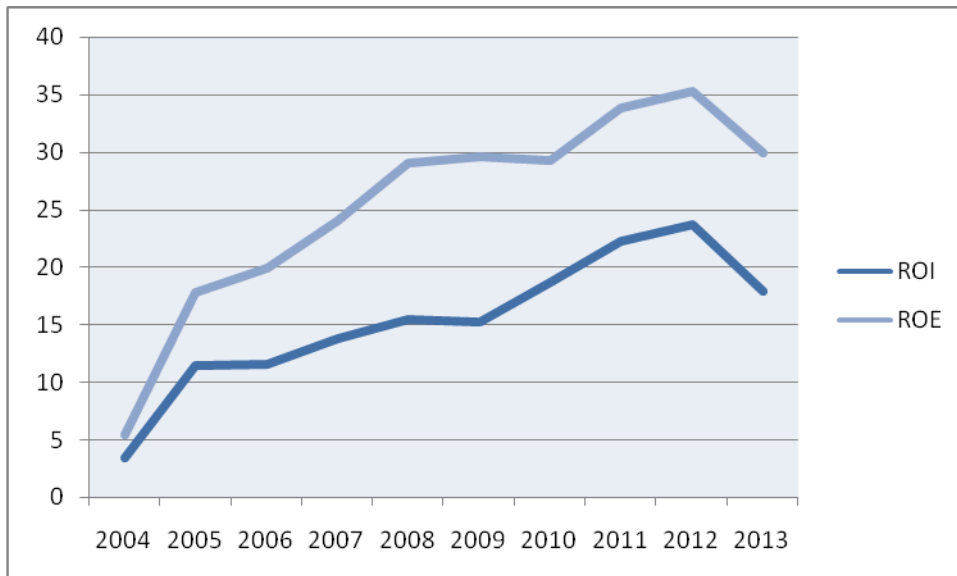
6. Dupont Analysis

A DuPont analysis of Samsung and Apple industry is shown in the table below. The story told by the DuPont analysis is similar to the story told by analyzing ratios.

	Apple	Samsung	Industry
ROE (Return on Equity)	29.97%	19.09%	27.47%
=	=	=	=
NPM (Net Profit Margin)	21.67	11.32	20.58
X	X	X	X
TAT (Total Asset Turnover)	0.82	1.16	0.82
X	X	X	X
A/E (Assets/Equity)	1.67	1.45	1.62
	Apple	Samsung	Industry
ROI (Return on Investment)	17.89%	13.13%	16.87%
=	=	=	=
NPM (Net Profit Margin)	21.67	11.32	20.58
X	X	X	X
TAT (Total Asset Turnover)	0.82	1.16	0.82

Apple is focusing on the profitability rather than the market as mentioned in the pages and therefore its ratios of the following and the DuPont analysis as well is more efficient.

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
ROI	3.42	11.496	11.56	13.792	15.462	15.292	18.638	22.275	23.703	17.89
ROE	5.43	17.78	19.92	24.05	29.09	29.58	29.32	33.83	35.3	29.97



7. Discussion

The apple company is a major developer and producer of mobile interaction gadgets, personal computer systems, and convenient digital press gamers. Apple Inc. has developed impressive technological innovations that have changed the computer and telecom sector rapidly and this was the result of the huge investment in R&D. One such revolutionary technology is Apple's Multi-Touch™ user interface, which allows customers to get around their iPhone, iPod touch, and iPad gadgets by hitting and using their fingertips on the screen.

A report published by United States District Court Northern District Of California claimed that Apple has changed the telecom and consumer electronics industry in 2007, when it brought the most popular iPhone in the market. iPhone was a new kind of mobile phones. They were touch screened, light weight and hand held devices with unmistakable look and they were eye catching too. iPod touch was also a new product that was offered by Apple in 2007. These products were very attractive to consumers that they started buying these. Similarly in 2010, Apple launched iPad, another revolutionary product, a computer tablet with coloured touch screen, it has the functionality of media storage playback and mobile computing. The era of Apple's innovative products were getting their way while most of the competitors of Apple were trying to imitate Apple and the major one was Samsung, which launched its Galaxy line of mobile phones and Galaxy Tablets, they have Google Android Operating System to fight with iPhone and iPad. Samsung, In spite of choosing a proper way, it copied the Apple's innovative technology, product design and packaging. Apple has patent rights of their products and by this action, Apple asked for the legal compensation for this illegal act by Samsung.

Apple/Samsung case raised on April 15, 2011, when Apple filed suit on Samsung for copying its technology and designs, infringement cases are ordinary in this industry but Apple's complaint was effective because they said that Samsung copied their technology with their trade dress (means total design). On the other hand Samsung also sued on Apple for violating

their wireless patents. The Court Jury found Samsung guilty as on violating four Apple's utility patents, four design patents and trade dress. (IIPTA)

The reputation of Samsung was effected by this case but still the market share of android is going up year by year.

Vendor	2012 Unit Shipments	2012 Market Share	2011 Unit Shipments	2011 Market Share	Year Over Year Change
Samsung	215.8	39.6%	94.2	19.0%	129.1%
Apple	136.8	25.1%	93.1	18.8%	46.9%
Nokia	35.1	6.4%	77.3	15.6%	-54.6%
HTC	32.6	6.0%	43.6	8.8%	-25.2%
RIM	32.5	6.0%	51.1	10.3%	-36.4%
Total (inc. others)	545.2	100.0%	495.3	100.0%	10.1%

The market share of iOS that was 18.8% in 2011 was at 25.1% in 2012, meanwhile Samsung gets it share doubled in this period from 18.8% to 39.6% in 2012. Although Apple had an opportunity to get more market share through the effected reputation of Samsung but according to Tony Bradley Apple owners are interested in making high profits through high quality smart phones with high prices instead of capturing the market share. Apple has not much share but its profitability is very high.

8. Suggestions & Recommendations

In a report published by Gartner (Research Firm) estimates that the number of Android devices which includes mobiles phones, computers and tablets, might show an increase of 26% in 2014 and would reach 1.1 billion by DawinderpalSahota. According to Gartner the iOS and Mac OS devices are consistently losing the market share to Androids, with 213,690 shipped in 2012; 266,769 shipped in 2013 and 344,206 expected to ship in 2014. Analyst firm Kantar Worldpanel ComTech also mentioned that the market share of iPhone is dropping down year over year. As mentioned by AvramPiltch 2014; there are some reasons why iPhone are lagging the race:

- Camera Feature is weak
- Battery life is poor, non removable
- No Near Field Communication (NFC)
- Sharing Options are few
- Touch screen is weak
- Limited Customization

Recently Samsung has also launched Galaxy S% on April 11, 2014, Galaxy is competing Apple on those areas which were pioneered by the Apple and Samsung is a worthy competitor of Apple by making its Galaxy line very strong. Victor Luckerson states that the Galaxy models have many advantages that are the reason of decreasing Apple's sales, at least for the current scenario. Here are five major reasons

- The Vast Screen
- Emergent Product Attraction
- The Heart Rate Monitor
- The Newness Factor
- The Marketing Push

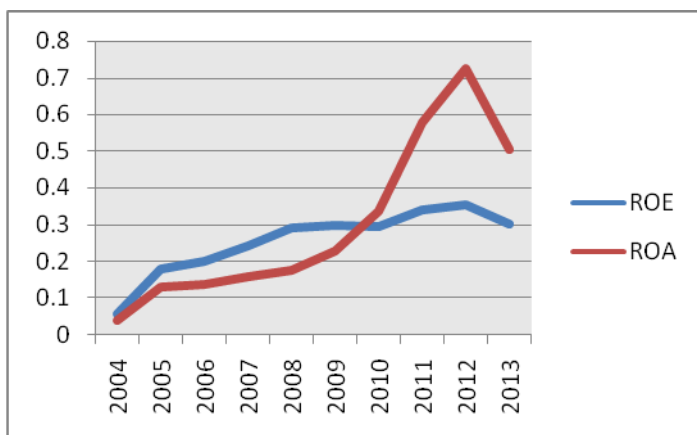
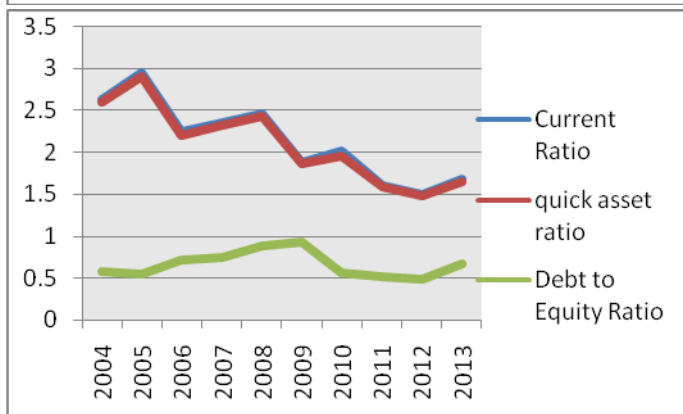
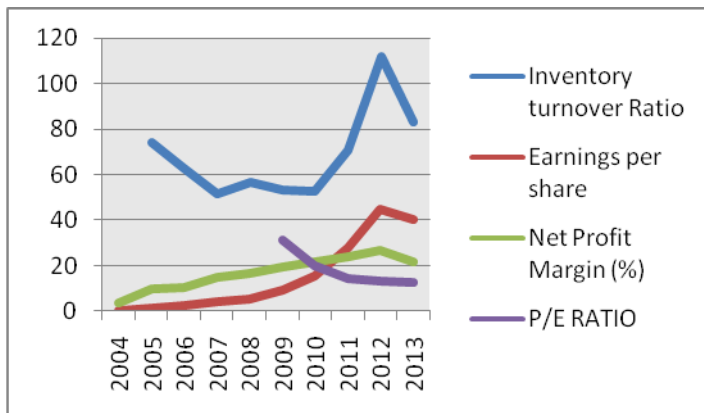
Apple should cover up these deficiencies in their iPhones so that to get the market share back from Android.

9. Conclusion

In this case the main focus of the study is the issue that was raised in the technology industry when Samsung copied the designs of the Apple iPhone and launched its Galaxy series. The case starts with the segment analysis of the Apple Inc. and the recent performance of the company and the industry by presenting its time series analysis and the ratio analysis. This analysis told us that Apple is highly profitable firm that after the copying of the patents still Apple is profitable and its performance is very well. The Vertical and Horizontal Analysis are also in line with the ratio analysis concluding that from 2007 to 2010 the debt portion was relatively higher as Apple was busy in product development but after this era Apple focused on the equity and in 2013 the profits goes on decrease due to the intense capturing of the Samsung Galaxy all over the world. Android now holds 80% of all the smart phone market and 50% hold on the tablet PC market. Apple, that was pioneer in the smar tphones industry, is now limited to just few geographical regions. The main reason was the Samsung's doing on the part of stealing the Apple designs and after 2011 Samsung defeated Apple in almost all parts of the world.

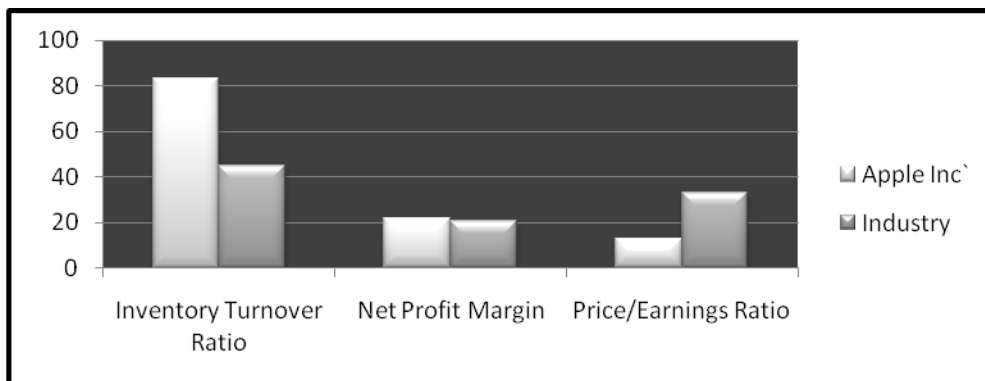
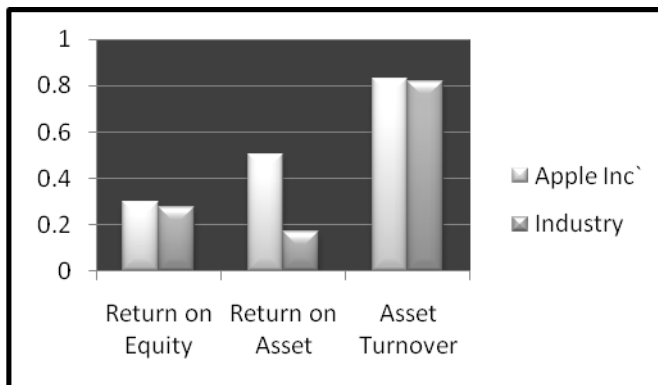
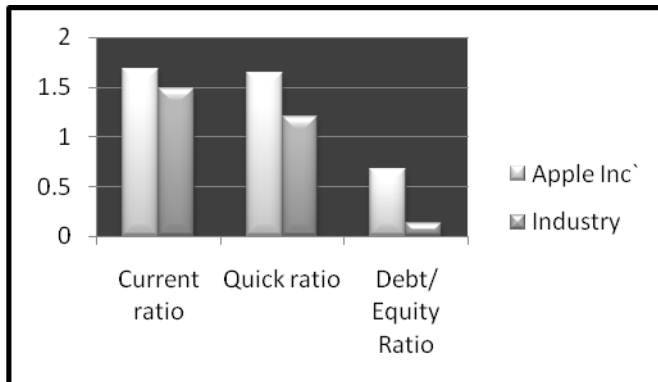
Annexure I

Time Series Analysis of Apple Inc. (2004-2013)



Annexure II

Industry Analysis of Apple Inc.



Annexure III

Vertical Analysis

	Cash & Cash equivalents	Accounts Receivable	Inventories	Total Current Assets	Long-term Marketable securities	Property, Plant and Equipment, net	Goodwill	Acquired intangible assets	Other Assets	Total assets
2009	9.773263	6.241295	0.844924	67.34322	19.55024	5.485506	0.382537	0.458673	6.779818	100
2010	14.97812	7.328784	1.397922	55.4354	33.77226	6.341859	0.985595	0.45489	3.009989	100
2011	8.434232	4.613692	0.666833	38.65912	47.79369	6.682936	0.769951	3.038558	3.055744	100
2012	6.103462	6.20797	0.449268	32.74548	52.32302	8.776354	0.644652	2.399128	3.111369	100
2013	6.888406	6.329469	0.852174	35.40386	51.31159	8.017874	0.761836	2.018841	2.48599	100

	Current liabilities	Accounts Payable	Current Debt	total current liabilities	Long-term debt	Total liabilities	Common Stock	Retained Earning	Accumulated other comprehensive income/(loss)	total shareholders' equity	total liabilities and shareholders' equity
		10.400	0	35.80	0	48.31	15.24	36.28	0.155986	51.68335	100
		15.981	0	27.56	0	36.43	14.18	49.43	-0.06118	63.56623	100
		12.573	0	24.03	0	34.16	11.45	54.00	0.380679	65.83685	100
		12.026	0	21.89	0	32.85	9.32	57.52	0.28342	67.14036	100
		10.805	0	21.09	8.193237	40.31	9.547	50.36	-0.22754	59.68551	100

Annexure IV

Horizontal Analysis

Items Years	Cash & Cash equivalents	Short-Term Investments	Accounts Receivable	Inventories	Total Current Assets	Property, Plant and Equipment, net	Goodwill	Acquired intangible assets	Total assets
2009	-55.68	44.28062	38.76961	-10.609	4.540213	20.32587	-0.48309	-13.3333	36.08359
2010	113.9654	-21.1087	63.9393	130.989	14.92624	61.40826	259.7087	38.46154	39.61301
2011	-12.8408	12.38248	-2.55898	-26.1656	7.94184	63.10822	20.91768	933.9181	54.78366
2012	9.485481	13.91832	103.5761	1.93299	28.15195	98.68844	26.67411	19.45701	51.29543
2013	32.69123	42.99625	19.87191	123.0088	27.11567	7.410044	38.94273	-1.06534	17.57088

	Accounts Payable	Accrued expenses	total current liabilities	Total liabilities	Common Stock	Retained Earning	Accumulated other comprehensive income/(loss)	total shareholders' equity	total liabilities and shareholders' equity
	1.467391	-60.616	36.82941	40.32467	14.3932	41.11954	950	32.34427	36.08359
	114.5153	69.52014	7.468105	5.276913	29.9391	90.23953	-154.762	71.71242	39.61301
	21.78111	61.5761	34.97732	45.13727	24.9625	69.06831	-1063.04	60.31261	54.78366
	44.71706	23.43463	37.79764	45.52269	23.18656	61.18299	12.64108	54.29094	51.29543
	5.62928	21.39478	13.27383	44.24413	20.35075	2.929242	-194.389	4.516538	17.57088

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