The Cheap-Smartphone Revolution

When the price hits $35 or less, it will have an astonishing global impact.

By ANDY KESSLER
May 12, 2014 6:48 p.m. ET

An iPhone costs $649. Other makers are talking about the $35 smartphone, or maybe even $25. That might explain why Apple has been so litigious over patents and why the company is spending big—about 30% more than last year—to develop new features. On May 2, Apple was awarded $119 million in damages after a court ruled that Samsung had infringed on patents by copying Apple’s features, designs and technology. But damage payments won’t stop what’s coming for the industry: We’re entering a revolutionary era of the cheap smartphone.

About 285 million smartphones were shipped in the first quarter of 2014, according to Strategy Analytics, and more than a billion will ship this year. Not cellphones—smartphones. Samsung and Apple accounted for almost half of them.

The business is staggeringly lucrative. The research firm iSuppli rips apart smartphones to figure out what the materials cost. iSuppli estimates that the materials in an 16-gigabyte iPhone 5S cost $191, though the product sells for $649 without a contract with AT&T or Verizon. The iPhone 5C materials come in at $166, selling for $549 without a contract. The Samsung Galaxy S5 contains $251 of materials.

But we’re not buying chips and glass. What we pay for is the experience of the look, feel and touch—for the software, operating system, graphical user interface and apps. Samsung and most of the other 85% non-Apple smartphones use Android, which Google provides free, making up for Android development costs by selling boatloads of search ads.

Apple thinks that its software is, unlike Android, worth more than free. The company filed the patent suit against Samsung and HTC to slow down Android’s development, but also to try to maintain the value of Apple’s code-writing that provides all the magical features. But it has been seven years since the iPhone was introduced. Commoditization, when consumers realize that your product is no different from what your competitor sells, is creeping up. When personal computers began, they sold for $5,000. Google now sells a laptop for $249. The same downward price pressure is about to happen with smartphones.

As Business Insider reported from the Mobile World Congress in Barcelona in February, the buzz was about a Chinese manufacturer showcasing a $35 smartphone and about Firefox’s flirting with selling one for $25. My contacts in China report similar prices.
We’re entering a new stage—call it the post-iPhone era. Cheap. Smart. Ubiquitous. Profits then flow to the best services that utilize smartphones. Facebook is cleaning up with its mobile-ad sales. Twitter, Snapchat and Instagram are all driven by smartphones. Uber and hundreds of new apps wouldn’t exist without smartphones. It makes sense that Apple is interested in acquiring Beats Audio for a reported $3.2 billion. And all this is at a billion smartphones. What happens at three billion devices? Or four billion?

First, dirt-cheap smartphones will have astonishing implications for the global economy: Smartphones are a productivity platform for wealth creation. Americans may waste days playing Piano Tiles or Clash of Clans, but the developing world can build lives with a $35 smartphone. Roughly 20% of the world population earns less than $2 a day, and the cost of a smartphone just dropped from a year’s earnings to three weeks’ pay. Now that’s an antipoverty program.

Google has launched Project Loon, bringing the Internet to rural and developing areas through high-altitude balloons. Facebook and Google are rushing to invest in drones to loop around and provide mobile connectivity. Poor villages and townships will finally have a platform to escape despair. Now we need applications to use $5-a-day workers to eyeball documents, photos, blueprints and anything that requires human cognitive skills, things that can’t yet and may never be coded into artificial-intelligence algorithms. This is the greatest challenge for Silicon Valley that it doesn’t even know about.

The other good news is for consumers in wealthy countries—those of us with "First World problems" like butt dialing. Apple and Samsung will struggle to maintain profits on high-end products, and so get ready for a horse race of features. We’ve already seen Apple’s Touch ID fingerprint scanner. Samsung has Smart Scroll Eye Tracking. Apple’s Siri answers spoken questions. Samsung offers a Galaxy Gear watch that works with their phones. None yet justify the $649 price tag.

A lot will be thrown at us to see what sticks. Larger displays? Curved or bendable displays? Fitness trackers? Google Glass? Bluetooth-connected rings to allow hand-waving gestures instead of requiring clicks? No-touch mobile payments? Medical sensors to track heart rate or glucose levels? Who knows? Let’s try them all. Personally, I’m hoping someone comes up with a personal assistant to whisper in my ear throughout the day.

Mr. Kessler, a former hedge-fund manager, is the author, most recently, of "Eat People" (Portfolio, 2011).