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TECH

The Inside Story of How the iPhone Crippled BlackBerry

'Losing the Signal' examines Research In Motion's efforts to take on Apple's game-changing smartphone

Research In Motion's Jim Balsillie, left, and Mike Lazaridis in 2006. *PHOTO: NORM BETTS/BLOOMBERG NEWS*

By JACQUIE MCNISH and SEAN SILCOFF
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Mike Lazaridis was home on his treadmill when he saw the televised report about Apple Inc. 's newest product. Research In Motion 's founder soon forgot about exercise that day in January 2007. There was Steve Jobs on a San Francisco stage waving a small glass object, downloading music, videos and maps from the Internet onto a device he called the iPhone.

BOOK EXCERPT

Condensed and adapted from the forthcoming book "Losing the Signal: The Untold Story Behind the Extraordinary Rise and Spectacular Fall of BlackBerry," to be released Tuesday.

"How did they do that?" Mr. Lazaridis wondered. His curiosity turned to disbelief when Stanley Sigman, the chief executive of Cingular Wireless joined Mr. Jobs to announce a multiyear contract with Apple to sell iPhones. What was Cingular's parent AT&T Inc. thinking? "It's going to collapse the network," Mr. Lazaridis thought.

The next day Mr. Lazaridis grabbed his co-CEO Jim Balsillie at the office and pulled him in front of a computer.

"Jim, I want you to watch this," he said, pointing to a webcast of the iPhone unveiling. "They put a full Web browser on that thing. The carriers aren't letting us put a full browser on our products."

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Mr. Balsillie's first thought was RIM was losing AT&T as a customer. "Apple's got a better deal," Mr. Balsillie said. "We were never allowed that. The U.S. market is going to be tougher."

"These guys are really, really good," Mr. Lazaridis replied. "This is different."

"It's OK—we'll be fine," Mr. Balsillie responded.

RIM's chiefs didn't give much additional thought to Apple's iPhone for months. "It wasn't a threat to RIM's core business," says Mr. Lazaridis's top lieutenant, Larry Conlee. "It wasn't secure. It had rapid battery drain and a lousy [digital] keyboard."

If the iPhone gained traction, RIM's senior executives believed, it would be with consumers who cared more about YouTube and other Internet escapes than efficiency and security. RIM's core business customers valued BlackBerry's secure and efficient communication systems. Offering mobile access to broader Internet content, says Mr. Conlee, "was not a space where we parked our business."

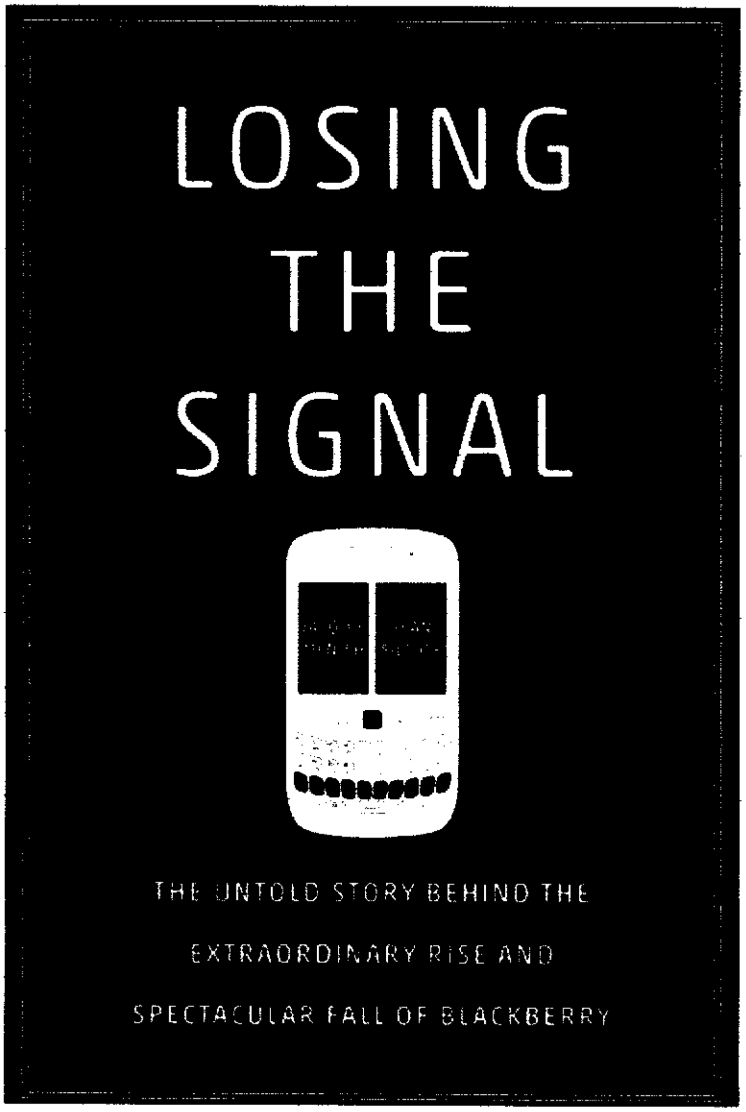

PHOTO: FLATIRON BOOKS

The iPhone's popularity with consumers was illogical to rivals such as RIM, Nokia Corp. and Motorola Inc. The phone's battery lasted less than eight hours, it operated on an older, slower second-generation network, and, as Mr. Lazaridis predicted, music, video and other downloads strained AT&T's network. RIM now faced an adversary it didn't understand.

"By all rights the product should have failed, but it did not," said David Yach, RIM's chief technology officer. To Mr. Yach and other senior RIM executives, Apple changed the competitive landscape by shifting the raison d'être of smartphones from something that was functional to a product that was beautiful.

"I learned that beauty matters....RIM was caught incredulous that people wanted to buy this thing," Mr. Yach says.

Verizon's Big Ask

RIM faced the iPhone threat by joining forces with Verizon Communications Inc. The powerful U.S. carrier understood that AT&T's exclusive deal to sell the iPhone was a serious competitive threat.

More than 1 million iPhones, dubbed the Jesus Phone, had been sold in its first three months during the summer of 2007. This was no ordinary phone. It was a cult with a devoted and rapidly growing following.

Verizon went searching for an antidote to viral iPhone sales in August and RIM, then the world's largest smartphone maker, was its chosen supplier. Mr. Lazaridis initially offered BlackBerry's planned new Bold phone, with its traditional keyboard and new touch-screen display, as the answer. But Verizon officials waved him off. If Apple and AT&T were gaining ground with a touch-screen phone, Verizon had to have one.

Mr. Lazaridis's solution was Storm, a phone that was little more than a prototype in 2007. Like the iPhone, Storm featured a glass screen. Unlike Apple's phone, it had a movable screen. Users could activate the phone's digital keyboard by pressing the screen down, replicating the click and tactile pleasure that made BlackBerry's physical keyboard so popular.

'There was a point where the carrier, by changing the rules, forced all the other carriers to change the rules eventually. It allowed Apple to reset what the expectations were. Conservation didn't matter. Battery life didn't matter. Cost didn't matter. That's their genius.'

—Mike Lazaridis, RIM's founder

Verizon officials loved Storm, promising a marketing budget of as much as $100 million to promote Storm in thousands of retail outlets. It was a huge breakthrough in the U.S. market for BlackBerry, and Mr. Lazaridis felt he couldn't say no even though Verizon set a punishing deadline of launching Storm by the spring of 2008.

The nine-month deadline came and went, and it wasn't until 15 months later in November 2008 that RIM was able to start shipping Storm phones for the busy Christmas season. Internally, most of RIM's engineers knew the company was shipping a flawed product.

The browser was painfully slow, the clickable screen didn't respond well in the corners and the device often froze and reset. Like most tech companies launching a glitchy product, RIM played for time. Verizon stoked sales with heavy subsidies, while RIM's engineers raced to introduce software upgrades to eliminate Storm's many bugs. "It was the best-selling initial product we ever had," says Mr. Lazaridis, with 1 million devices sold in the first two months. "We couldn't meet demand."

Storm's success was fleeting. By the time Mr. Balsillie was summoned to Verizon's Basking Ridge, N.J., headquarters in the spring of 2009 to review the carrier's sales data, RIM's senior executives knew Storm was a wipeout. Virtually every one of the 1 million Storm phones shipped in 2008 needed replacing, Verizon's chief marketing officer, John Stratton, told Mr. Balsillie. Many of the replacements were being returned as well. Storm was a complete failure, and Mr. Stratton wanted RIM to pay.

"You're going to make us whole on the money we've spent fixing your Storm product problems," Mr. Stratton told Mr. Balsillie, "or we'll revisit our whole supplier relationship with you. This is your responsibility. We expect you to step up because this is your fault, not ours." Verizon wanted RIM to pay close to $500 million to cover the carrier's losses.

"I can't write a check like that," Mr. Balsillie said.

Instead, he and his team walked Mr. Stratton through an alternative solution. Mr. Balsillie offered Mr. Stratton a range of concessions, including a free repair and upgrade program and a cache of complimentary BlackBerrys. The fix would cost RIM more than $100 million, a cost that would barely dent RIM's income statement compared to the bath it would have to take to make Verizon whole.

Mr. Stratton wasn't happy, but he had little choice. Verizon had signed a "take-or-pay" deal, meaning it was stuck with the units it committed to buy. Mr. Stratton wouldn't get his $500 million, but he warned Mr. Balsillie that the carrier's relationship with the Waterloo, Ontario, company would change dramatically.

Storm's Wake

For the first time since it went public, RIM had delivered a product that widely missed the mark. Given the opportunity to vault past Apple and regain its lead in the smartphone race, RIM had fallen short. RIM was used to winning praise and adulation for its devices; now critics were questioning whether it could still innovate.

"Everybody was upset. It was demoralizing for the whole organization," says Chief Operating Officer Don Morrison. "You're shattering the very fabric of what BlackBerry stood for."

Mr. Conlee says, "We thought it was within our ability to get it done. We were wrong. I think people were embarrassed."

Only Mr. Lazaridis didn't regard Storm as a failure. To him, it was RIM's first crack at a new technology. When he looked at Storm, Mr. Lazaridis saw its technical achievements: It had a good camera, video-streaming capabilities, a great speaker and a replaceable battery. It was Verizon's first 3G device. Most of all, he loved the clickable screen. Mr. Lazaridis hated the sensation of typing on glass, of using a touch-screen keyboard that didn't physically respond to every click. He couldn't fathom that consumers might not love his clickable screen—it had to be the fault of his staff for delivering a poorly built product.

"We let Mike down, in his mind, because he made a request and we didn't deliver," says Mr. Morrison. "Whether the request is reasonable or not is not part of that sentence."

Mr. Yach, chief technology officer in charge of software, shouldered much of the blame from Mr. Lazaridis for Storm's shortcomings. "He would say, 'You must have crappy people,'" Mr. Yach says. "He was clearly frustrated. From his perspective he felt that he was let down."

Mr. Lazaridis was convinced Storm was the kind of device BlackBerry should continue to improve. RIM would take another stab at a clickable screen with Storm 2. Even though sales were tepid, Mr. Lazaridis persisted with the clickable Storm screen until 2010, when U.S. carriers finally lost interest.

Although the market rejected his initial touch-screen approach, Mr. Lazaridis believed the four pillars of BlackBerry's success—good battery life, miserly use of carrier's spectrum, security and the ability to type—still ruled in the new smartphone world and gave his company its competitive advantage. Two years after Apple's launch, it still amazed Mr. Lazaridis that iPhone users had to cart around adapters to power up depleted batteries. His early prediction that Apple would cause AT&T headaches by using up its network bandwidth also proved right.

But there was no going back. Apple was setting a new agenda for the wireless industry. RIM, like others, were now followers. "We built a perfectly evolved, optimized service and product offering that made the industry take off," says Mr. Lazaridis. "There was a point where the carrier, by changing the rules, forced all the other carriers to change the rules eventually. It allowed Apple to reset what the expectations were. Conservation didn't matter. Battery life didn't matter. Cost didn't matter. That's their genius. We had to respond in a way that was completely different than what people expected."

Strategic Confusion

If the failure of Storm sent Mr. Lazaridis back to the lab with a sense of purpose, it left Mr. Balsillie winded. For a leader who thrived on ambiguity, Mr. Balsillie found it hard to grapple with the new competitive dynamic.

To Mr. Balsillie, RIM was in an existential crisis, mired in what he describes as "strategic confusion." The company's business had been disrupted on several levels, with no obvious path forward. Was RIM supposed to defend BlackBerry's QWERTY keyboard, or jump all-in and become a touch-screen smartphone maker? Was it supposed to challenge Apple at the high end of the smartphone market or focus on the lower end with devices like its Curve and Gemini models, which were driving heady sales gains in foreign markets where Apple wasn't yet a factor? Should the company stick to its closed, proprietary software technology or open its platform?

One of the biggest puzzles was what to do about apps. For years Mr. Balsillie had fought carriers for the right to sell apps to customers, reassuring them RIM was "constructively aligned" with the wireless carriers. Then Apple waltzed in with an app store despite AT&T exclusion from any app revenues.

Now RIM was forced to play catch-up. Unlike RIM, Apple had an army of outside developers who had already built consumer apps for its computers and iPods and were primed to do the same for the iPhone. By the time BlackBerry launched its app store in spring 2009, iPhone customers had already downloaded 1 billion apps. Was RIM taking the right approach, Mr. Balsillie wondered, or should it stick to its "constructive alignment" narrative and leave the sale of apps to carriers?

Mr. Balsillie struggled with each question. "The Storm failure made it clear we were not the dominant smartphone company anymore. We're grappling with who we are because we can't be who we used to be anymore, which sucked...It's not clear what the hell to do."

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