Microsoft Acquires Nokia: Implications for the Two Companies and Finland

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**Lead-In**

Microsoft’s acquisition of Nokia’s phone business has considerable implications for Nokia and potentially for Finland as a country, but little immediate effects on Microsoft and related industries. One might ask, couldn’t there have been better remedies for the challenges both Microsoft and Nokia were facing?

One has to further ask, why Nokia’s board suddenly abandoned the strategy it has endorsed for almost three years, especially when there finally were signs that the plan might actually come to fruition. Nokia’s chairman of the board, Mr. Siilasmaa, defended the company’s decision stating that Nokia didn’t have the resources to successfully promote its smartphone business. He further explained that the two companies failed to find another strategy that would have been victorious for both sides.

One could also wonder whether the acquisition improves Microsoft’s position in any material way, particularly in the consumers’ eyes. In a press conference in Espoo (Finland) today, CEOs Ballmer and Elop assured their optimism for the new Windows Phone software and hardware entity. At the same time, however, information provided today suggests that Nokia can re-enter the phone business any day, albeit with certain limitations.

Finally, what comes to possible effects on employment, the Finnish labor market has absorbed the previous batches of ex-Nokia employees quite well. Short-term difficulties aside, we remain optimistic regarding the broader ICT sector in Finland – the surge in demand for, and application of, software and IT services across all sectors may well continue.

These are the burning hot questions of today. In this brief, we first take a step back and look at the big picture before addressing them in detail.

**How the Mighty Fall**

Up until the launch of Apple’s iPhone in 2007, and Google’s Android in 2009, Nokia and Microsoft were indisputable leaders of their own respective industries. Since then they were both caught by the rapid convergence of digital communications, information systems, consumer electronics, as well as software and digital content of various sorts. This convergence broke the previously prevailing sectoral silos and replaced them with a rapidly evolving Internet of everything world. Both companies found themselves facing new and unknown competition, and were forced to design new strategies fit for a new market regime.

The titans have clashed over the dominance of this this huge and yet-to-be conquered domain.
So far Goliaths, such as Nokia and Microsoft, have been unable to capitalize on their old competitive advantages. More agile Davids, such as Amazon, Apple, Facebook, and Google (with its arms-length allies such as Samsung), have done better in establishing lucrative early positions.

But so far we have only seen the first battles in a lengthy war. How does Microsoft’s acquisition of the Nokia Devices & Solutions unit in September 3rd, 2013, change the respective positions of the two companies? And what does it imply for Finland as a country? We address these questions in this Brief.

**Industry Developments Prior to the Acquisition**

Figure 1 illustrates how rapidly Nokia’s Symbian operating system (OS) for mobile phones lost its global market share in smartphones and how Microsoft’s Windows Phone OS failed to gain ground. One should note, however, that Figure 1 underestimates Nokia’s overall role, as Nokia fared better in feature phones. On a similar note, the decline of Symbian’s market share after 2011 was part of Nokia’s strategy to switch to Microsoft’s operating system.

As illustrated, the iPhone started a new era of smartphones, but the death knell for the early leaders was the rise and subsequent dominance of Google’s Android OS.

One of the consequences of the digital convergence has been that our digital lives have become less tied to a particular screen. Thus, it makes sense to consider the market shares of OSs across the three main terminals for digital creation and consumption, i.e., PCs, smartphones, and tablets. As Figure 2 shows, Microsoft still dominated this space quite recently. By the end of 2012, however, Android had become the biggest OS in terms of this metric.

These developments have had significant consequences on companies’ financial performances and valuations, as Figures 3 and 4 show. Nokia in particular has found itself between a rock and a hard place. Upon becoming Nokia’s CEO in September 21, 2010, Mr Elop’s internal slogan forebodingly proclaimed: “Fix the phone business or get out of business”. While it is too early for the final verdict, he may have done both.

**Nokia’s Ill-Advised Marriage with Microsoft Windows OS**

With the benefit of hindsight, it is clear that Nokia rode its Symbian OS far too long. Slow progress in developing its Linux-based earlier Maemo OS, later MeeGo OS to replace Symbian added to the insult. Nokia was left with a set of undesirable choices.

Looking back, it seems clear that either sticking with MeeGo or hopping on the Android bandwagon would have been better choices for Nokia as a company. It is nevertheless true that, at the time, Microsoft seemed like the most logical choice. Once the mistake was done, both jumping ship and having a dual OS strategy were...
ruled out due to “speculative” contractual reasons and obligations.

Upon his arrival at Nokia, CEO Elop had to choose the least-worse strategy – the good ones had been exhausted by his predecessors. With its rapid cash burn rate, Nokia was in a vertical tailspin, so he needed something fast. At that time Android’s winning streak was far from obvious and one’s opportunities to differentiate with that ecosystem seemed slim.

**What Was Actually Acquired?**

Microsoft is acquiring Nokia’s Mobile Phones and Smart Devices business units including Nokia’s design team and its operations, all related production facilities, sales and marketing functions, and related activities. In total, Nokia transfers 32,000 employees to Microsoft, of which 4,700 in Finland.

Microsoft licenses, but does not acquire, non-related Nokia IPRs: a non-exclusive license of patents for 10 years, right to the Nokia brand for 10 years, and certain rights in relation to HERE services. Nokia is restricted in the use of its own brand in mobile devices for 30 months or until the beginning of year 2016, but the deal announced today does NOT prevent Nokia from making mobile devices carrying other brands.

The cash price of the deal is €5.44 billion (of which licenses and future options account for €1.65 billion), and it is to be closed in the first quarter of 2014 pending Nokia’s shareholders and regulatory approval. The sales of the acquired unit were €14.9 billion in 2012, almost half of Nokia’s net sales.

Nokia is left with NSN, its digital content services carrying the HERE brand (including digital maps and navigation it gained after acquiring Navteq), a considerable portfolio of patents and other intellectual property related to, e.g., 2G and 3G telecommunications standards, and Nokia Research Center.

**Why Did Nokia Sell?**

At this point there are few good answers to why Nokia sold the businesses. The answer may simply be that it was running out of cash. Obviously the board of Nokia lost faith in its Windows OS strategy and, with the still binding contractual obligations, was lacking good alternatives. One should note that, with the assets it still retains, Nokia remains a force in mobile communications. To our knowledge it can still make mobile phones, using any OS, as long as they are not marked under the Nokia brand.

**What Does the Post-Acquisition Nokia Look Like?**

Nokia’s communications network business as well as its Navteq acquisition and other HERE businesses are doing reasonably well. Nokia’s IPR portfolio should provide a steady revenue stream, roughly €0.5 billion annually as Mr. Siilasmaa indicated in the press conference. While the new Nokia is only a shadow of the Nokia in
the early 2000s, it has all the potential to succeed, even though good growth opportunities are scarce.

It should be noted that due to this deal, Nokia’s loss streak has come to an end and the company obtained more than €5 billion in cash. Due to the improved financial standing, Nokia has plenty to spend on new businesses via, for instance, acquisitions or in-house development.

**Microsoft Still Has a Few Aces Up Its Sleeve**

The strongest and the most binding lock-in Microsoft retains over its customers relates to its Office application suite. While particularly corporate professionals’ reliance on Excel and PowerPoint is not to be underestimated, this strength is undeniably eroding with alternatives such as Google Apps.

Furthermore, Microsoft continues to be a leading provider of corporate IT solutions. MS continues to hold up reasonably well in the client-server architectures segment. Here the threat comes from cloud computing rather than from more direct competition.

Since full support and update services for Microsoft’s Office and server solutions are provided on its own Windows operating system, it has extra staying power that complements its huge installed base and unmatched variety of third-party PC applications.

In our view Microsoft’s current strategy rests on three cornerstones:

- Roll out one nearly identical, seamless, and synchronized interface across all digital devices (i.e., Xbox, Lumia phones, Surface tablets, and computers).
- Provide a solution that effortlessly stores all aspects of one’s digital life (i.e., SkyDrive).
- Offer manageable and secure back-end solutions to support the above in all desirable configurations (local infrastructure, public vs private cloud, etc.).

Microsoft has a fair chance in succeeding with the above strategy, but so far it has been unable to make the right moves in a timely manner.

As the examples of Apple and Google show, the key to a successful digital ecosystem is to attract third-party application and content providers. End-users also appreciate the ability to mix-and-match their favorite applications/content across platforms. Microsoft has not been particularly strong in neither attracting developers nor nurturing openness of its offerings. For instance, Windows Phone users are locked into Microsoft’s Internet Explorer and to a large extent also to its Bing search engine. As far as end-users are concerned, these issues may be important, as a strong preference for a particular solution—say for Google search—may determine the choice of one’s preferred digital ecosystem.

**The Acquisition from Microsoft’s Vantage**

Apple and Google have an increasing presence in hardware. Microsoft’s own phones and tablets have failed so far. Nokia Lumias have accounted for over 80% of Windows Phones and currently have a nice line up of offerings. Microsoft had the cash and Nokia’s assets were available at fire sale prices, so why not? First and foremost this seems like an incarnation of MS’s “me too” strategy, however.

Nokia’s success in handsets has been crucial to the whole Windows ecosystem, but it has been insufficient to turn the ecosystem into a real third alternative. With the acquisition Microsoft is undeniably, albeit only marginally, in a stronger position in building the Windows ecosystem. The move fits to MS’s overall strategy but is hardly enough in itself.

After a few years of gloomy news, Nokia has shown positive signs this fall. One has to ask why Nokia’s board abandoned the strategy now, unless of course Nokia’s cash crisis is even deeper than anticipated. In the coming months we’ll know whether Microsoft timed its move perfectly. Even if not, the damage to its pocketbook was not too severe.

As for the industry at large, the acquisition has hardly any immediate and, most likely, only minor long-term effects.

**Impacts on Finland as a Country**

The acquisition significantly affects Nokia’s impact on the Finnish economy. At the peak of Nokia’s success in 2000, the company accounted for 1% of the total employment in Finland. In June 2013, Nokia’s share of the country’s total employment was 0.4–0.5%. Due to the divestment of the Devices & Services unit, in 2014 Nokia’s will employ approximately 6,100 in Fin-
land which is about 0.2% of the total employment in Finland (Figure 5).

A similar effect is expected to hit Nokia’s share of R&D expenditures in Finland. Nokia’s share of corporate R&D in Finland remained stable at slightly over 40% until 2009. Subsequently the share declined. In 2012, Nokia accounted for 31% of corporate R&D in Finland. After the acquisition the share will drop to approximately 17%.

The effects the deal has on Nokia’s contributions to employment and R&D do not necessarily impact the Finnish economy as a whole. For instance, if Microsoft retains all 4,700 ex-Nokia employees, the impact of the deal on the employment on a national level is potentially negligible (Figure 6). Thus, the total impact on the national economy depends on choices made after the acquisition. The key issues to be considered are: Will Microsoft succeed in its mobile phone business? Will Microsoft maintain employees in Finland? Would the long-term fate of these 4,700 individuals be any different if the deal had never happened? Will Nokia invest its new cash reserves at least partially in Finland?

Be that as it may, the exceptional period when a single company dominated a remarkably big share of the Finnish GDP is over (Figure 7). In the early 1990s, Finland transformed from being one of the least information and communication technology-specialized countries to becoming the single most specialized one in the world. The success of Nokia was one of the major factors in pulling Finland out of the most severe economic crisis in any OECD country since World War II. As a result, Nokia’s share of the Finnish GDP increased rapidly. But since 2007 the share declined as fast as it rose ten years before. In 2012, Nokia’s share of the Finnish GDP was actually negative.

The counter-intuitive observation calls for further explanation. When we calculate Nokia’s (including NSN) value added in Finland as the sum of

- local labor costs,
- local depreciation,
- local rents, and
- the operating profit (or loss) recorded in Finland,

we obtain a negative figure. Due to Nokia’s heavy losses recorded in Finland, in particular, the value added of Nokia in Finland was nega-
tive. From a technical viewpoint the procedure is correct: Finland is Nokia’s global profit-and-loss center – in better times the operations in Finland enjoyed “excess profits” and in worse times they suffered “excess losses”.

Despite Nokia’s misfortunes in recent years, ICT sector employment in Finland has not decreased drastically. As Figure 8 shows, software and IT services have largely filled the void. The analysis reveals that a dramatic structural change has occurred within the ICT sector. While ICT hardware manufacturers have shed their workforce, software firms have recruited more staff in Finland. Thus, the Finnish ICT sector does not rely only on Nokia anymore.

The past few years have witnessed the birth and growth of new ICT companies. The most visible of those are game makers Rovio and Supercell. But there are also thousands of other software companies in Finland.

The vitality of the Finnish ICT sector requires not only new establishments but also successful divestments of existing operations. Only the future will tell the total impact of the Microsoft–Nokia deal on the Finnish economy.

![ICT Sector Employment by Sub-categories in Finland](image.png)

Data: Statistics Finland.