Commentary and Analysis...

September 3, 2013

J.Gold Associates LLC, 6 Valentine Road, Northborough, MA 01532, USA
www.jgoldassociates.com +1-508-393-5294

Microsoft's Finnish Line?

Microsoft announced they are buying the devices business of Nokia. While there have been rumors circulating to this effect for many months, especially once Stephen Elop took over as Nokia CEO, it nevertheless surprised me, mostly because I believe Microsoft already had the best of both worlds the way things were.

As I read this, Microsoft is buying Nokia's handsets and services businesses, but leaves the current Nokia with the networks division and mapping. Microsoft also licenses Nokia's mapping software to power mobile Bing maps (not a surprise since Nokia Here (aka Navteq) is an integral part of the Nokia handsets anyway and probably inseparable at this point). Finally MSFT licenses Nokia patents for 10 years. So all this leaves Nokia with the networks division, mapping division and ownership of its patent portfolio to carry on as a separate entity.

Microsoft and Nokia were already codependent. Nokia was all-in on Windows Phone, and Microsoft really had no other major outlets for its OS on handsets (e.g., HTC and Samsung, once supporters, are overwhelmingly invested in Android now). Microsoft and Nokia could have continued their current close partnership. So why did Microsoft do this?

For Microsoft, I think it's as much about getting Elop back as it is getting into the handset business, although certainly having handsets under their own roof was not a trivial decision. Buying Nokia's handset business is the most logical way to quickly get into the direct for mobile devices, a stated goal of the "new" Microsoft strategy. Nokia is wholly dependent on Windows Phone and Microsoft anyway (except for it s lower end Asha phones, which is not of much interest to Microsoft) and because of this very close relationship, they already know each other extremely well.

What I find really interesting is that Microsoft didn't just buy all of Nokia outright (and then spin-off the divisions it doesn't want/need). They certainly could have afforded to. This indicates to me several possible scenarios. One, that Nokia was in high distress as its device sales were not as good as needed to make it a long term viable player in smartphones. Possible, but I don't think they were in imminent danger of collapse, and in any event Microsoft could have bailed them out (again). Two, that Microsoft really wanted to compete head to head with Apple and Google, both of which have their own HW divisions and Microsoft sees this as an existential threat. It's true that Ballmer has said devices and services is Microsoft's future, so having Nokia as part of this mix is important to that vision. But is Microsoft simply (over) reacting to what Apple and Google are/have done in the marketplace with their vertical integration? And three, that Microsoft sees great benefit in having actual product engineers with experience in mobile on the staff to invigorate the internal product team, which to date has not done a stellar job in getting Windows adopted in mobile. This could actually be one of the primary benefits of Microsoft buying Nokia's handsets. They don't really need a manufacturing arm- that's easy enough to outsource. But real engineering expertise is not so easy to come by.

It's also interesting that Microsoft is not buying Nokia's patents outright. This has as much to do with the long term viability of the patents (many may be reaching end of life and/or have limited monetary generation capability), but also about wanting to avoid the potential litigation around monopoly that Microsoft could face (Nokia patents are licensed by many other vendors). Microsoft can also avoid the legal hassle of enforcement, since now essentially a holding company (Nokia that's left over after acquisition) will deal with that. Great move as its much cleaner just to license the patents without all the baggage.

But in the final analysis, a key factor as I see it is that Microsoft gets Elop back on board as an exec. That is a clear indication that Microsoft needs additional "new thinkers" when it comes to management, and when it comes to new products. Elop did a good job at Nokia, given the cards he was dealt, and his presence may spur Microsoft to rethink some of its strategy as he leads the mobile team. Importantly, in my assessment, this puts Elop at the top of the list of potential successors to Ballmer. And of course, its quite possible that Elop was already approached on becoming the heir apparent, and said he would only do it if he didn't throw Nokia to the wolves by leaving in troubled times.

I am not convinced in the long run that buying Nokia will achieve the goal of making Microsoft a leader in mobility. Google hasn't done so well with Motorola after it acquired a device company (although the HW was not the primary motivation for Google, and it has much higher revenue generation potential in other places to subsidize this). Other failed acquisitions loom large (remember HP/Palm?). And Microsoft now runs the risk of essentially alienating any key OEMs of mobile devices who were inclined to license Windows Phone. This may even extend to tablets, as Nokia will probably now assume the leadership position within Microsoft of designing and building tablets (especially in light of the rumored Nokia RT tablet). Microsoft may gain a competitive posture against Apple (which in my opinion is vulnerable to attack on this front), but it may not easily achieve what it is looking to do. At the end of the day, Microsoft has to compete on the attractiveness of Windows to the end user, and just having a device producer on board doesn't get them there. Nor will having Nokia on board dramatically extend Microsoft's ecosystem in mobility, which is a key problem for them to deal with. Mobile today is a business of scale (as BlackBerry, HTC and others are discovering). Does this acquisition give Microsoft that scale? I don't think its enough to matter.

Overall, I'm skeptical that long term this is a winning strategy for Microsoft in Mobile. I think they could have achieved the same thing through their existing strategic partnership with Nokia by simply "staking" Nokia to the funds it needed (which they have done in the past). It remains to be seen how Microsoft leverages this new devices company it now is about to own. We should know how successful it is in the next 1-2 years. I'm not optimistic.

Commentary written by Jack Gold, Principal Analyst.
For more in-depth comments or analysis on this or other subjects, feel free to contact us.