

In Nokia acquisition, Microsoft tries to catch up

September 4 2013, by Matti Huuhtanen



Standing together are from left to right, Nokia's new CEO Timo Ihamuotila, Chairman of the Board Risto Siilasmaa and former Nokia CEO Stephen Elop, during the press conference of the Finnish mobile manufacturer Nokia in Espoo, Finland on Tuesday, Sept. 3, 2013. Microsoft has announced a takeover of the Finnish mobile phone company Nokia in a deal reported to be worth some 5.44 billion euros (US dlrs 7.2 billion). (AP Photo / LEHTIKUVA, Markku Ulander)

Microsoft's acquisition of Nokia's troubled smartphone business represents a daring \$7.2 billion attempt by the software giant and a once-

influential cellphone maker to catch up with the mobile computing revolution that threatens to leave them in the technological dust.

The deal announced late Monday offers both companies a chance to make up for lost time with a strategy to meld their software and hardware into a cohesive package, like rival Apple has done. But there are plenty of reasons to question whether the copycat approach will pay off.

Unlike Apple, Microsoft Corp. makes most of its money from software for personal computers—a still-profitable franchise that has gradually been crumbling as smartphones and tablets supplant laptop and desktop machines. By some estimates, more than two-thirds of the computing devices being sold now are either smartphones or tablets, and there are few signs that trend will change during the next decade.

To complicate Microsoft's transition, the Redmond, Wash., company is being led by a lame duck. Microsoft CEO Steve Ballmer, who negotiated the Nokia deal, recently announced plans to retire within the next year in a tacit admission that the company needs a different leader to blaze new trails.

The managerial limbo raises even more doubts about whether Microsoft will be able to turn Nokia's phones into more effective weapons in a mobile-computing battle against devices powered by Google Inc.'s Android software and Apple Inc.'s iPhone and iPad.

"It's a three-horse race, and Microsoft knows it needs to come up with a more well-defined plan for mobile devices to catch up," said Darren Hayes, a computer science professor at Pace University in New York. "This was an essential acquisition for them."

The Nokia deal didn't go over well with investors who have already

become weary of Microsoft's largely fruitless efforts to evolve into something more than a PC-dependent company.

Microsoft's stock shed \$1.52, or 4.6 percent, to close Tuesday at \$31.88. Nokia Corp.'s shares surged \$1.22, or 31 percent, to finish at \$5.12.

Nokia, a Finnish company, has seen its cellphone business unravel since Apple revolutionized the way people use handsets with the 2007 introduction of the iPhone. Nokia's problems grew worse in 2009 after Google began giving away its Android software to smartphone makers, spawning an array of sleek, low-cost alternatives.

In an attempt to bounce back, Nokia lured Stephen Elop away from Microsoft to become CEO nearly three years ago. That move has not worked out well for Nokia's shareholders. Even with Tuesday's rally, Nokia's stock remains about 40 percent below where it stood when Elop became CEO.

Despite those losses, Elop has emerged as a candidate to replace Ballmer as Microsoft's CEO. Elop is stepping down as Nokia's CEO to re-join Microsoft, where he will oversee the company's devices division. Nokia board Chairman Risto Siilasmaa will serve as the company's interim CEO.



Nokia's new CEO Timo Ihamuotila, left, shakes hands with Chairman of the Board Risto Siilasmaa during a press conference for Microsoft and the Finnish mobile manufacturer Nokia in Espoo, Finland, on Tuesday, Sept. 3, 2013. Microsoft has announced a takeover of the Finnish mobile phone company Nokia in a deal reported to be worth some 5.44 billion euros (US dlrs 7.2 billion). (AP Photo / LEHTIKUVA, Markku Ulander)

Elop decided to abandon Nokia's old operating system in 2011 in favor of Microsoft's Windows system for phones. That move established Nokia as Microsoft's most important partner in the mobile device market. About four out of every five phones running on Windows are made by Nokia, according to the latest information from research firm International Data Corp.

Nokia accounted for such of large chunk of Windows phones largely

because other manufacturers such as LG Electronics, Samsung Electronics and HTC have either been scrapping the system or de-emphasizing its use in favor of Android, said Forrester Research analyst Charles Golvin.

Microsoft still hopes to license its Windows software to other smartphone makers. In return, the company receives less than \$10 in royalties for each Windows smartphone sold.

Although Nokia's line of Lumia phones has received some positive reviews, they still have not won over enough fans to establish Microsoft as a formidable force in smartphones.

Phones running on Windows have 4 percent of the worldwide market, leaving them a distant third to Android-powered devices at 79 percent and Apple's iPhone at 13 percent, according to IDC.

"We know we need to accelerate. We're not confused about that," Ballmer told investors and analysts Tuesday. "We need to be a company that provides a family of devices."

Microsoft is betting that it can develop a more appealing line of Windows phones if the hardware and software are more tightly wound together. That's a concept that propelled the success of Apple's iPhone and iPad, whose operating systems are tailored specifically for those devices. Apple also maintains a rigid screening process for applications.

Hayes thinks Microsoft's Nokia deal is also similar to Google's \$12.4 billion acquisition of Motorola Mobility Holdings, another struggling cellphone maker, completed last year. Like Microsoft, Google wanted to secure its own pipeline of mobile devices to serve as a showcase for its Android software and other online services.

Just like Google did with Motorola, Microsoft is also buying the rights to a portfolio of valuable mobile patents with the Nokia.



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Microsoft's purchase price consists of 3.79 billion euros (\$5 billion) for the Nokia unit that makes mobile phones. Another 1.65 billion euros (\$2.2 billion) will be paid for a 10-year license to use Nokia's patents, with the option to extend it indefinitely.

The money to buy Nokia's smartphones and patents will be drawn from

the nearly \$70 billion that Microsoft held in overseas accounts as of June 30.

The deal with Nokia represents the second most expensive acquisition in Microsoft's 38-year history, ranking behind an \$8.5 billion purchase of Internet calling and video conferencing service Skype. Tony Bates, who ran Skype, is also regarded as a potential successor to Ballmer.

Although Google executives have insisted that they are pleased with Motorola Mobility's progress, analysts say it's still unclear if that deal will ever merit the steep price tag. Motorola Mobility has lost \$1.7 billion under Google's ownership so far.

Some analysts are worried about Nokia becoming a financial drag on Microsoft. If the deal closes by early next year, as Microsoft expects, the company will inherit 32,000 Nokia employees. That will represent a nearly one-third increase in Microsoft's current payroll of 99,000 employees.

Microsoft believes Nokia will begin to increase its adjusted earnings during the fiscal year ending in June 2015. That projection hinges largely on Microsoft's hopes to sell about 50 million Windows-powered smartphones annually. Reaching that goal will require a roughly 40 percent increase from the current pace of Windows phone sales, based on IDC's second-quarter numbers.

Microsoft's expansion into mobile devices hasn't fared well so far. Last year, the company began selling a line of tablets called Surface in hopes of undercutting Apple's iPad. The version of Surface running on a revamped version of the Windows operating system fared so poorly that the company absorbed a \$900 million charge in its last quarter to account for the flop.

"This is a logical step, but it's only a small step in the direction of having a more integrated approach to hardware and software," Golvin said of the Nokia deal. "The challenge for Microsoft is how to provide everything that customers want in a clear and unified way, no matter what device that customer might be holding, whether it's a phone, a tablet or an Xbox controller."

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Citation: In Nokia acquisition, Microsoft tries to catch up (2013, September 4) retrieved 10 April 2024 from <https://phys.org/news/2013-09-nokia-acquisition-microsoft.html>

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