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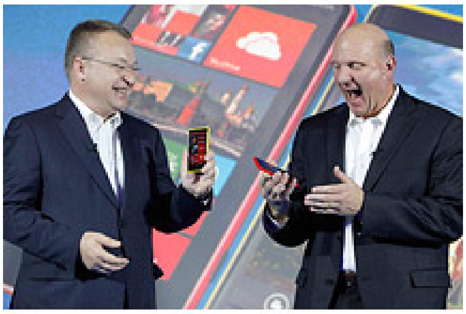
Nokia's Future Is Smaller—and Probably Brighter

By Joshua Brustein September 03, 2013

Microsoft & Nokia



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On the one hand, Nokia's (NOK) decision to sell its mobile phone business to Microsoft (MSFT) is a Finnish tragedy. At Nokia's peak, the tech company contributed a quarter of Finland's economic growth for about a decade; at one time it paid 23 percent of what Finland collected in corporate taxes. It may be up to Angry Birds to carry the national torch.

Still, getting out of the mobile phone business is probably a blessing for Nokia. Life is grim these days for second-tier smartphone companies. Nokia's global market share in the mobile phone market has dropped to 14 percent, down from 19.9 percent a year ago, according to Gartner. The revenue the company brings in from its devices and services division is down by more than half since 2008. Perhaps most ominously, Nokia doesn't register at all on the list of top smartphone sellers. Analysts say the Microsoft deal marks the end of an era in mobile devices. BlackBerry (BBRY) and HTC (2498:TT) are also at risk of being swept away by this shift, and the argument could be made that Nokia's strategic retreat should inspire some envy in their boardrooms.

The struggle against Apple (AAPL) and Google (GOOG) is now Microsoft's problem. It makes a certain amount of sense for Microsoft to bring Nokia in-house as it chooses this fight, given that Nokia phones already make up over 80 percent of the Windows phones worldwide. But while Windows Phone recently surpassed BlackBerry as the world's third most popular mobile operating system, that step to No. 2 is a doozy. In the second quarter of this year, 8.7 million Windows phones shipped worldwide, compared to 31.7 million iPhones and 187.4 million Android phones, according to IDC. Microsoft apparently plans to do its best Apple impersonation, abandoning a more Google-like strategy of licensing its smartphone operating system to other companies. This is a tough sell; skepticism about the deal drove Microsoft stock prices down almost 2 percent on Tuesday morning.

Nokia, meanwhile, will piece together a more modest, perhaps more sustainable future as a networking, mapping, and patent-licensing company. "They have the chance not to go bust and to continue investing in the businesses where they make money," said Francisco Jeronimo, an analyst at IDC.

The biggest part of the company is now NSN, which makes networking and telecommunications equipment. NSN already makes up 45 percent of the company's sales and seemed set to surpass the devices business this year. "Nokia Siemens has a future in the network equipment world, with a streamlined operation and a No. 2 position in a now-concentrated and -stable market," Pierre Ferragu, an analyst at Sanford C. Bernstein, told Bloomberg News in July, when Nokia bought out Siemens (SI), its partner in the networking business.

Nokia is also hanging onto its mapping business, HERE, which makes up about 4 percent of the company's sales. It's interesting that Microsoft didn't acquire this aspect of Nokia's business, given the hunger for mapping companies shown by Apple, which acquired four mapping companies this year, and Google, which recently spent $1.1 billion for Waze, the Israeli crowdsourced traffic app. Instead, Microsoft and Nokia reached a cross-licensing agreement on patents that will allow HERE to use Microsoft patents. Microsoft is also paying Nokia for a four-year license to use the mapping platform.

Both the networking and mapping businesses are profitable, according to the company's internal measure of operating income. The devices business is not even close. In shedding the devices business, Nokia will be getting rid of over half of the costs it says it lays out to generate revenue—and about 32,000 employees. (Given that one of these employees is the company's chief executive, Stephen Elop, there has to be some question as to how the company's future will shape up.)

Nokia's latest pivot is hardly its first. The company got its start as a paper mill and made galoshes and car tires before taking its first steps into mobile communications in 1979. Shedding its identity as a leading headset company probably hurts the most. It effectively ends Nokia's run as a household name—no one is going to be raving about a really good networking equipment company. Still, Nokia could end up being the winner in this deal. Sometimes you have to get out while the getting is good.

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