

# Nokia: A bet with a safety net

By Richard Milne and Daniel Thomas

The ailing company is betting on a new smartphone but some believe salvation lies elsewhere



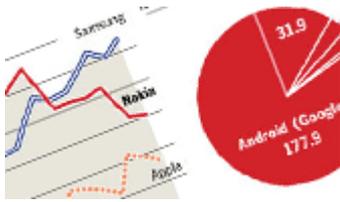
Sole focus: Stephen Elop, chief executive of Nokia, says it is committed to using only the Windows Phone operating system

As [Nokia](#) was developing its latest smartphone, Stephen Elop came up with an unusual challenge for the engineers. Mr Elop, the Finnish company's Canadian chief executive, would stand in the darkened corner of a room while the engineers stood on the other side, taking his picture. The goal? To see if they could produce a photograph sharp enough so that you could tell the time on his watch. Eventually they did.

Mr Elop's attention to the smallest detail makes sense. After dominating the global mobile phone business – at its peak in 2008, Nokia sold 468m handsets – the group is struggling to find its way in a market dominated by smartphones made by [Apple](#) and Samsung. The company sold just 123m handsets in the first half of this year, and is no longer even in the top five smartphone makers. Since 2011, it has clocked up more than €4bn in pre-tax losses.

This means that a lot is riding on the new phone, the [Lumia 1020](#), Nokia's most important product of the smartphone era. With its 41 megapixel camera – used by the engineers to zoom in on Mr Elop's watch – Nokia has finally made a smartphone that allows it to claim technology leadership. "We found our roots again," says Samuli Hanninen, head of software program management.

## Dethroned



## Nokia and its rivals

But despite a spate of good reviews, analysts fret that, based on anecdotal sales evidence, the 1020 will do little to lift Nokia out of its sales trough.

Like [BlackBerry](#), another fallen giant of the mobile phone world that recently put itself up for sale, the Finnish group was caught napping when Apple introduced the iPhone six years ago. BlackBerry stands as a cautionary tale for Nokia for what could happen if Mr Elop's big wager – a partnership with [Microsoft](#) – fails.

Mr Elop, a former senior Microsoft executive, ditched Nokia's own operating systems shortly after taking over in 2010 and bet the company on the Windows Phone. The idea is that the platform from Microsoft – which has a spotty record with consumer devices – would become the third big operating system behind Apple's iOS and Google's Android.

The problem is that Windows-based phones are so far behind – with global market share of 3.3 per cent compared with a combined 93.2 per cent for Google and Apple, according to research group Gartner – that many analysts and investors are calling for Nokia to come up with an alternative. “Many of the owners want to see a plan B,” says Hannu Rauhala, analyst at Pohjola Bank in Helsinki.

But Mr Elop is unwavering. “We are focused on Windows Phone,” he says in an interview.

Sitting in a meeting room at the group's seaside headquarters outside Helsinki – sold and leased back as part of a recent drive to preserve cash – the 49-year-old reflects on his call in 2011 to be judged in two years' time when Nokia had a full portfolio of Windows smartphones. “One of the things to judge, does Nokia have more manoeuvring room today than we did two years ago? And I would argue we definitely do and it's because we do have a handset business in Lumia that's now moving in the right direction,” he says.

Other parts of the business, largely obscured in recent years by the battle for relevance in smartphones, are creating their own strategic challenges. Basic mobile phones – long a cash cow because of heavy demand from emerging markets – are suffering a drop in sales as a result of competition from cheap Androids.

NSN, its telecoms equipment business, has moved from a perennial underperformer to its strongest division. That raises the question of whether it could replace mobiles as the cornerstone of the company, especially amid rumours of a possible sale of the handsets unit.

Nokia's recent €1.7bn move to [buy partner Siemens out of NSN](#) has also raised renewed questions about how strong its cash position is. A former member of Nokia's senior leadership team says: “In 2015 Nokia could look very different. The focus has all been on smartphones in recent years. But now Stephen has a lot of big decisions ahead across the company.”

Yet the question of smartphones remains the most crucial, with some analysts assigning the business no value against estimates of €5bn-€8bn for NSN. Lumia sales are rising, up one-third in the second quarter to 7.4m. But that pales into insignificance next to Samsung's 71.3m and Apple's 31.9m in the same quarter, according to Gartner.

That leads to some ambivalence from telecoms operators – Nokia's real customers – which two years ago were desperate to have an alternative to Android and Apple. "The problems are being addressed at least," says one large Nokia customer. "Nokia is no longer in denial. They appreciate the problems. [But] it all depends on how long it takes to fix them."

Operators say they are not willing to carry Windows phones forever if they do not gain market share. One telecoms executive says he is disappointed with Nokia's performance. Samsung, he adds, sells the phones customers want at present.

The chief executive of a global mobile group says: "We are focused on supporting them in all our markets as it would be great news if Nokia could become a key player again, given the overconfidence of Apple. But it has been very hard in smartphones. I don't honestly see any recovery so far for them."

Mr Elop says goodwill previously shown by operators has now in many cases "translated into commitment" from operators such as [AT&T](#). The two companies are working together to set targets for market share, to train staff and share marketing costs.

A European telecoms executive says his company's research shows that in almost every leading market the three top brands are Apple, Samsung and Nokia. "People haven't given up on the brand," he says.

The problems, and opportunities, facing Nokia are summed up by data from another European telecoms operator. The confidential report shows that the company has had the highest increase in so-called "net promoter scores", which measures handsets being recommended by customers.

It scored well on customer satisfaction, too. But the problem is getting customers even to try Nokia. Only 5 per cent of potential smartphone customers expect to buy one, and most of those already have one of its devices, the report found.

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- The chief executive of a global mobile group

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Another problem is that few agree on what precisely Nokia needs to change after making its big bet on Windows phones. Some analysts warn that it may be too late to jump platforms even if it wanted. But Mr Rauhala thinks it should have another operating system alongside Windows, such as the recently unveiled one based on the Firefox internet browser, while some telecoms operators think it would be better off with Android.

Mr Elop says Nokia discussed introducing the Windows Phone alongside other operating systems but decided against it. He adds that “there are no debates within the company: should we do this camera feature on Windows Phone, should we do it on some other operating system? Should we do it on both? No time wasted on that.”

Samsung’s domination of the Android market – with four out of five sales – means it would be difficult for Nokia to stand out, Mr Elop says.

His company is dominant in the Windows Phone market as other manufacturers lose interest or are forced to focus more on Android to counter Samsung. Nokia accounts for 87 per cent of Windows sales now, according to a report from AdDuplex.

That is both good and bad for Nokia: the positive is that Microsoft and operators are focused on Nokia rather than dividing attention on other groups such as [HTC](#) and Samsung. The negative is that Nokia is wedded to Microsoft’s operating system and needs it to succeed.

Gaining momentum is harder if Nokia is the only group really to adopt Windows, which has far fewer apps than Android or iOS – including important ones such as Instagram. This had led to some frustration between Nokia and Microsoft.

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In recent months an intriguing plan B has emerged – a sale of Nokia’s mobile business. Microsoft reportedly held talks with Nokia over the prospect. Mr Elop says he has “no comment whatsoever”.

Analysts say it makes sense, given the company has become the de facto provider of Microsoft’s mobile devices. Huawei’s handset chief said in June it [could consider buying Nokia](#).

A banker close to Nokia says: “Nokia is a very pragmatic company. I don’t think they feel secure. Things are going better but they are coming off a low base.” He adds: “They think that if they want to pull the plug on devices they can go with NSN.”

NSN has emerged from a deep restructuring as the one division that is profitable at an operating level. The €1.7bn paid to Siemens for its 50 per cent stake is widely seen as a bargain. And that raises the prospect for some of a Nokia built around NSN.

Pierre Ferragu, an analyst at Bernstein Research, says NSN is “where the future is. At some point they will stop losing money on handsets but it remains a low-margin feature phone business with a smartphone niche, whereas NSN is the number-two provider of wireless in the world.”

Mr Elop argues that Nokia’s options with NSN have increased. “We could IPO it, we could distribute it to our shareholders, we could do different things. It could become more strategic as well.”

The NSN deal also has analysts focusing on Nokia’s balance sheet again. Its net cash position will fall to €2.4bn after paying Siemens, down from €7bn at the end of 2010. Some analysts have even speculated that at the current cash burn rate it could run out some time next year.

(Underlining the concern, Moody's on Thursday downgraded Nokia's credit rating to B1, saying the company was unlikely to reach break-even on a cash flow basis before well into 2014.)

Mr Elop dismisses concerns that Nokia will run out of cash, adding that it can always cut investments if needed. Not that he thinks that will be necessary, especially as NSN is generating good cash revenue at present. Kristian Pullola, Nokia's financial controller, says its mobile business came close to breaking even in cash terms in the second quarter once restructuring costs were stripped out.

Despite NSN's success and the struggles of the mobile business, Mr Elop says he will keep investing heavily in handsets. He points to the analyst reports giving no value to mobiles and says that means the potential upside is infinite.

"My point being that as we continue to build that momentum, that will attract value. So the way you look at these things is to the extent that you believe that through investment you can drive a significant increase in shareholder value, then it's worth pursuing."

Two years after asking investors to withhold judgment until now, Mr Elop remains in a battle to keep Nokia relevant in a fast-moving world. "I would love to be further along, I would love for things to be moving up faster but I sure love that they're going in the right direction, so it's a good place to be," he says.

### **Rivals already looking past the smartphone**

Before the mobile phone revolution made it one of the biggest tech companies in the world, Nokia seriously considered selling its (then) tiny handset business, **writes Daniel Thomas in London.**

Nokia veterans point to this story, dating to the early 1990s, to make a point: never rule out the Finns.

But the company's dilemma is different now. Back then, the world was on the verge of a decade-long explosion in mobile phone use. This time, however, the company is coming at the tail-end of the smartphone boom. Some warn that the market could be all but over.

Two years after the launch of Windows Phones, Nokia has introduced new products that are slowly clawing back ground lost to rivals. But analysts warn that the company may have left it too late to enjoy the profits in a competitive market where margins are falling as Asian manufacturers begin to dominate.

More worrying for some telecoms executives, there appears to be a lack of innovation in the smartphone market, even at the higher end. Questions about its ability to keep innovating have dogged Apple, which helped create the smartphone market.

"We have just reached the end of the smartphone cycle," said a senior global telecoms executive with knowledge of future "road maps" of handset makers.

"There is nothing very exciting to come now that no one has seen before," he claims. "Something new will need to come along."

Profits in the mobile telecoms market are shifting to companies that find innovative ways to use the mobile internet, with names such as Facebook and Google putting mobile at the heart of their strategies.

Other companies, such as Apple and Samsung, seem to be moving on. Both are said to be vying to produce smart watches that use the touchscreen, camera, speakers and motion sensors of the modern smartphone. Google is unlikely to stop at its already launched internet-connected glasses.

Finding the next market is key for these groups as well as Nokia. In a fast-moving industry, consumer preference is constantly shifting and able to pull down even the best-loved brands – as Nokia has already found more than once to its heavy cost.

#### Comments

1. [Report](#) LondonGuy | August 23 11:28am | [Permalink](#)

He called it wrong nailing his colours to MS thinking the Android market was already crowded. I'd dump my iPhone in a heartbeat for a quality Nokia phone leveraging Google's ecosystem of great search, maps and stuff. MS? No thanks. This would be the #1 phone smashing Samsung's cheap plastic rubbish in a 1/4.

2. [Report](#) Guy Sheard | August 23 9:24am | [Permalink](#)

Integration of devices is clearly the key, along with information security. Blackberry may well be the player to make the move here. I just went over to Blackberry with the Z10 from Android. Great functionality, far more apps than Windows and information security - as well as now needing only one work and personal phone.

I have information integration with the Playbook and Z10. I can use that to watch great videos on flights on the train etc. Just takes a bit more searching to find relevant apps. Think Android is going to be the one slipping from here with BBRY and APPL the gainers. I prefer to buy european where possible so would have preferred Nokia, but the Windows operating system and lack of tablet integration put me off.

3. [Report](#) JeanDarch | August 23 8:48am | [Permalink](#)

Nokia got its Plan B already year 2009 internally, year 2010 externally:  
- [http://www.theregi...a\\_manifesto\\_risku/](http://www.theregi...a_manifesto_risku/)

Nokia's problem is that they don't "do the whole widget" like Steve Jobs used to say. The whole widget in ICT, Internet and media is TAIC-SIMO, and Nokia is not there:  
- <http://abstraction.../21/design-driven/>

Also, Nokia has only the smallest media screen, the phone. With one product you can't survive. You need all (ALL) media screens:  
- <http://abstraction...siness-what-is-it/>

Well, could Nokia start the Interest Machine™? No, because there are no skills and leadership anymore:

- <http://interestmachine.wordpress.com/>

So, no need for Plan B anymore.

4. [Report](#) 186k | August 23 8:45am | [Permalink](#)

Within a year: Elop will be OUT & Andriod IN @ Nokia

5. [Report](#) Bryce Williams | August 23 8:38am | [Permalink](#)

It doesn't matter what the specs are if the operating system is wrong. With apps as an increasingly dominant factor, the network effect applies. Andriod is to mobile what Windows was to the desktop. Surely, Microsoft, of all people, should appreciate its power.

Nokia need to produce an Android phone. The rest is window dressing.

6. [Report](#) chainsmoker | August 23 7:32am | [Permalink](#)

In tablets, notebooks and desktops combined, MS OSs have ca. 85% share of net traffic, compared to ca. 12% share of apple and 2% share of google.

With the chosen strategy apple does not even pursue a larger share. Google, in turn has a long way to go.

Within Windows ecosystem the PCs and tablets are integrating rapidly. There will be a number of different "form factors", but the operating system & applications and user experience will be unified and integrated. There is no need for customizing "apps" separately for each different screen size, as is the case for android and iOS. To me its obvious that tablet strategies of apple and google are already doomed and the integrated Windows ecosystem (blue) will take over.

What are the OS integration actions taken by apple and google?

Nothing shown yet. Do they honestly think of ruling the world with unscalable mobile operating systems and some watch/glass accessories?

Slowly, but surely, windows ecosystems take over. Why? Because MS ( and Nokia and Lenovo etc.) seem to work systematically towards a goal while the competition focus on trolling and developing dead ends.

As an investor, do not be fooled.

7. [Report](#) MetroGnone | August 23 7:28am | [Permalink](#)

As John Kay presciently noted, there comes an end time for companies too. The very things that made BBerry and Nokia famous are just not factors any more.

BBerry thrived in an era when secure email was it's sole purview and did so by innovative use of what was a very primitive data "drip system". BBerry used as much data in a week as today's smartphones do just when first waking up.

Nokia was famous for many things chief among which was battery life and build quality.

Battery life was the product of very limited capability processors coupled with extremely and

painfully optimised software. This "computational resource frugality" was shunned by developers as it required a lot of hard work to master. Today's apps are positively gargantuan in their demands and focus is on ease of development and time to market; not eking out every last ounce of power from an underpowered processor. Which is why today a day's charge is considered adequate.

What is their unique and distinguishing feature today? Cameras? Give me a break. Nowadays there are cameras out there that 5 years ago were only found in dedicated cameras not phones. BBM? Not in the days of WhatsApp and Hangouts and everything else. Qwerty keyboards? HTC and Sony brought out decent android phones with keyboards but they didn't sell so there really is no demand there.

The main lesson for all players is that: Good enough coupled with some increased real utility, will always win the day. The iPhone was for years inferior to the Nokias spec-wise but what mattered was it was good enough and brought new utility as well as brute forcing telecoms into submission making them offer unlimited data in an era where mere kilobytes were gold dust. Would Nokia ever have fought the telecoms in such a way? Not in a million years. Let's face it, companies ebb and flow and sometimes it's best to just call it a day return the money to the shareholders and call it a day.

8. [Report](#) Citizen of Singapore | August 23 7:26am | [Permalink](#)

When Microsoft finally gets their OS 8.xx correct, Nokia can create their brand new segment of tablets and present to the world a whole new series of lower-cost higher quality phones, tablets and devices. With its move to cut their own manufacturing and outsource; Nokia is certainly well placed to ride on the single OS that Microsoft is creating and still tinkering. Sooner or later, they will get it right.

Who can live with the many versions and forks of Android? Just look at those wonderful single purpose device coming from China in so many forms and this is the creation of a brand new market of devices. The smart crooks will have a field day cracking/hacking these devices and stealing information and money!

Sooner or later, people will ONLY use OS that can be trusted. Although the OS may get hacked but at least Microsoft will attempt to fix it.

The smartphones, tablets and devices will be coming to us at 1/3 the prices of what we pay today. The whole market for these devices will be huge and be very different.

Samsung's strategy of investing billions each year to produce those relatively tiny profits when they read the market correct (until now) is very dangerous for them. Imagine, they get it wrong and it is goodbye to their image, credit ratings and flexibility.

As consumers, we can only look forward to enjoy ourselves with every decreasing costs of devices.

9. [Report](#) Greenwashed | August 23 6:29am | [Permalink](#)

So, in summary, the smartphone market is maturing and no one has any idea whether the current market leaders (Apple, Samsung), will still be the market leaders 5 years from now. Who was predicting that Apple and Samsung would be No.'s 1 and 2 in 2008? Nokia and Blackberry should keep at it, but they might also consider producing phones with different

OS's. Since Android is popular right now, they are foolish not to compete in that market segment.

10. [Report](#) KLRJ | August 23 5:29am | [Permalink](#)

Operating schmoperating, just come back with a phone with a qwerty keyboard. Blackberry's kicking the can. Millions of us -- no kidding -- still want that. The Asha 2G jokes don't cut the mustard.

11. [Report](#) Patrick M. Crowley | August 23 4:27am | [Permalink](#)

If it is successful Nokia should buy Jolla, the Nokia employee spinoff that is just about to launch a phone with the Sailfish OS - it is a great alternative to what is out there and is innovative in terms of its gesture based usage and "the other half" back covers. Jolla is also based in Helsinki so integrating the employees back into Nokia would not be a big problem if they wanted to come back. Most people don't realize that all the Lumia series handset designs are based off of the N9, the ground-breaking Meego OS phone. It sold really well, but Elop decided it was a distraction - I think that was the only mistake that Elop made and it is now pretty easy to correct.

12. [Report](#) VSO | August 23 2:12am | [Permalink](#)

In 1898, Eduard Polón founded Finnish Rubber Works, manufacturer of galoshes and other rubber products, which later became Nokia...

13. [Report](#) VSO | August 23 2:08am | [Permalink](#)

For contingency purposes Nokia can always go back to the Company roots and resume manufacturing galoshes.

14. [Report](#) Felix Drost | August 23 12:17am | [Permalink](#)

Is he really wearing yellow shoes in that picture? What's that supposed to communicate to shareholders other than absolute cluelessness?

15. [Report](#) Felix Drost | August 23 12:14am | [Permalink](#)

Why why why why why why why is there no Android Nokia Phone as well as a Windows Nokia Phone? It would be so terribly easy to develop an Android version of the Lumina. And if it is what people want (which it is), and if it is what could help Nokia's bottom line (which it will, Samsung also makes Android and Windows phones). Then why on Earth not?

Nokia is a valuable brand, and a company vital to Finland. The failure of Windows phones could cost a European country and a prime brand dearly.

Stephen Flop and his monocular Microsoft obsession ought to be replaced posthaste.

16. [Report](#) Henry Law | August 22 10:47pm | [Permalink](#)

Will it be possible to hack the hardware and run a non-MS operating system?

17. [Report](#) lateotw | August 22 9:31pm | [Permalink](#)

Windows OS could be the single most naive decision that sank the ship for Nokia. Dozen's of small phone manufactures are producing Android devices at a profit in Asia, while Nokia is stuck in its own Windows world.

18. [Report](#) StevenB | August 22 9:10pm | [Permalink](#)

Nokia should realize that cellphone market is no longer fought over who offers the best camera or best music. Get a 'decent' OS for your phones before its too late!!

19. [Report](#) gmgartner | August 22 8:24pm | [Permalink](#)

telecoms operators – Nokia's real customers: They should focus on the users and create products able to be sold directly. Users want low rates, not cameras. Team up with those that provide low rates, definitely not the big telecoms operators.