The Economist

Nokia tries to reinvent itself
Bears at the door

Jan 7th 2010 | ESPOO
From *The Economist* print edition

Can the world's largest handset-maker regain the initiative?

ASK Finns about their national character and chances are the word *sisu* will come up. It is an amalgam of steadfastness and diligence, but also courage, recklessness and fierce tenacity. "It takes *sisu* to stand at the door when the bear is on the other side," a folk saying goes.

There are plenty of bears these days at the doors of Nokia, the Finnish firm that is the world's biggest maker of mobile handsets. Although it is still the global leader in the fast-growing market for smart-phones, its devices are losing ground to Apple's iPhone and to the BlackBerry, made by Research in Motion (RIM). On January 5th Google took a further step into the market with the launch of the Nexus One, a handset made by HTC of Taiwan that the internet giant will sell directly to consumers, and which runs Android, Google's operating system for smart-phones.

Especially in America, where Apple and RIM reign supreme in the smart-phone market, many already see Nokia as a has-been. Developers are rushing to write programs for the iPhone and for Android, but shun Symbian, Nokia's rival software platform. And Nokia's efforts in mobile services, mostly under its Ovi brand, have yet to make much headway.

When the company makes headlines these days, it is thanks to the patent lawsuits it has filed against Apple, which many have interpreted—perhaps unfairly—as an admission of commercial defeat. The latest suit, filed in late December, asks America's International Trade Commission to ban various Apple products, including the iPhone, from entering the country.

Nokia beats Apple in annual sales ($57 billion versus $37 billion) and market share in smart-phones (39% versus 17%), but it is much less profitable. In fact, Nokia's share of industry profits fell from 64% in 2007 to 32% in 2009—not much more than Apple's and less than RIM's, according to Brian Modoff, an analyst with Deutsche Bank. Small wonder that Nokia's market capitalisation is barely a quarter of Apple's.

Yet in Nokia's headquarters in Espoo, near Helsinki, morale is far better than one might expect. Hardly anyone would deny that there are problems. But executives insist that they can be overcome. When board members met financial analysts in December, they made some bold predictions. Within a year, promised Olli-Pekka Kallasvuo, the firm's boss, the ageing Symbian software will have been vastly improved, to enable Nokia to offer "magic devices". As for services, the goal is to have signed up 300m users by the end of 2011. "I've rarely heard such explicit statements," says Ben Wood of CCS Insight, a long-time Nokia watcher.

Nokia has overcome many crises in the past. In 1995 poor logistics caused it to stumble. It responded by developing one of the world's most efficient supply chains, capable of churning out some 1.2m handsets a day. A decade later it failed to anticipate the demand for "clamshell"-type handsets, but bounced back quickly to restore its market share in handsets to 40% and thus its industry dominance.

But this time the problems go deeper. In more than one way, Nokia has to become a different company, says Jay Galbraith, a management expert. Until now, it has excelled in making and distributing hardware. This has trained the organisation to focus on planning and logistics. Deadlines are often set 18 months in advance. Teams developing a new device also work in relative isolation and even competitively, to make each product more original. And although Nokia has always done a lot of market research and built phones for every conceivable type of customer, it sells most of its wares to telecoms operators and designs its products to meet their demands.

With the rise of the smart-phone, however, software and services are becoming much more important. They require different skills. Development cycles are not counted in quarters and years, but in months or even weeks. New services do not have to be perfect, since they can be improved after their launch if consumers like them. Teams have to collaborate more closely, so that the same services and software can run on different handsets. Nokia also has to establish a direct relationship with its users like Apple's or Google's.

To Nokia's credit, it anticipated the shift to software and services much earlier than other handset-makers. It launched Ovi in 2007, almost a year before Apple opened its highly successful App Store. A few months later, Nokia bought Navteq, a maker of digital maps, for a whopping €5.7 billion (then $8.1 billion), to be able to offer better location-based services. Shortly thereafter, Nokia launched Comes With Music, an innovative pairing of a handset with a digital-music subscription.

These efforts have not been great successes, although Nokia says that 86m people now use its various services. The firm is still working at bundling a selection of them into a neat package that is easily accessible from its handsets. Moreover, most of its offerings have to compete against popular incumbents, such as Facebook, Apple's iTunes store and Google Maps. To further complicate matters, telecoms operators are reluctant to let Nokia offer services directly to their customers, since they want to do the same.

Worse, while dealing with these problems, Nokia has seemed to neglect its main business. The first version of its flagship smart-phone, called the N97, was a let-down. It has as many bells and whistles as a Swiss army knife, says Carolina Milanesi of Gartner, a market-research firm, but its software, based on Symbian, makes them almost impossible to use. “It is like having a Ferrari body with a Fiat Cinquecento engine inside,” she says.

Last February Nokia’s management kicked off what is internally known as a “transformation project” to address all these concerns. “We needed to move faster. We needed to improve our execution. And we needed a tighter coupling of devices and services,” explains Mary McDowell, Nokia’s chief strategist. The firm has since introduced a simpler internal structure, cut its smart-phone portfolio by half, ditched weaker services and begun to increase Ovi’s appeal to developers by allowing them to integrate Nokia’s services into their own applications. While giving Symbian a makeover it is also pushing a new operating system, called Maemo, for the grandest, computer-like smart-phones.

All this will no doubt help Nokia come up with better, if not magic, products. The firm may even reach its goal of 300m users by the end of 2011 because its efforts are not aimed just at rich countries, but at fast-growing emerging economies where Nokia is still king of the hill, such as India. There, services such as Nokia Money, a mobile-payment system, and Life Tools, which supplies farmers with prices and other information, fulfil real needs, says John Delaney of IDC, another market-research firm.

Yet it is an entirely different question whether Nokia will manage to dominate the mobile industry once more—not just by handset volumes, but by innovation and profits. The example of the computer industry, in which the centre of gravity began shifting from hardware firms to providers of software and services over two decades ago, is not terribly encouraging: of the industry’s former giants, only IBM really made the shift successfully. Then again, Nokia has reinvented itself many times since its origin in 1865 as a paper mill. That, points out Dan Steinbock, the author of two books on the firm, is thanks not only to *sisu*, but also to a remarkable willingness to embrace change and diversity. Nokia will need those traits in the years ahead.

###