

# Nokia SEC Report Outlines Significant Risks

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Nokia bared its soul in the company's annual Form 20-F report to the Securities and Exchange Commission (SEC), revealing a \$1.8 billion loss in 2011, as well as coming clean on the myriad risks related to its all-in strategy on Microsoft's Windows Phone mobile platform.

Mobile phone volumes decreased 3 percent to 339.8 million units in 2011, compared to 349.2 million units in 2010. Nokia attributed the decline to a challenging competitive environment, especially during the first half of the year due to a lack of dual-SIM phones, which continued to be a growing part of the market. The company also felt pressure from a variety of competitors on pricing.

Nokia said it faces intense competition in feature phones, where a different type of ecosystem from that of smartphones is emerging, involving very low-cost components and manufacturing processes, with speed to market and attractive pricing being critical success factors.

The company said that lower component costs and more efficient manufacturing processes have lowered the barrier to market entry and enabled extremely low-cost feature phones in China and India.

But it is Nokia's smartphone play that could ultimately decide the company's fate going forward. While Nokia made good on its promise to bring its first Windows Phone smartphones to market by the end of 2011, adoption of the platform by consumers has been slow going. Yesterday's filing with the SEC sheds some light on the very real risks inherent in Nokia's strategy.

The report describes low-cost Android phones, which often sell for under \$125, excluding taxes and subsidies, as a major challenge for Nokia, whose feature phones have been the choice for many customers looking for a low-end mobile.

"In general, we believe product differentiation with Android is more challenging, leading to increased commoditization of these devices and the resulting downward pressure on pricing," the report stated. "In addition, there is uncertainty in relation to the intellectual property rights in the Android ecosystem, which we believe increases the risk of direct and indirect litigation for participants in that ecosystem."

Nokia explains that the iOS and Android platforms, with their complete ecosystems, have made it harder for new players to squeeze into the market on another operating system. "As with any new platform, we may not succeed in developing it into a sufficiently attractive and competitive smartphone platform," the company admitted in the report.

Among a host of possible risks, including a lack of developer support for Windows

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Phone, differentiation and problems scaling, Nokia also said that a lack of compatible devices beyond the smartphone could be an issue.

"We manufacture mobile devices, but currently no other adjacent products, such as tablets, computers and other connected devices," the report noted. "As a result, Nokia products with Windows Phone may be a less compelling choice for consumers who wish to purchase multiple mobile products from the same manufacturer or with the same or compatible operating system in order to facilitate a smooth interaction among mobile products and electronic products of different types and screen sizes, such as mobile devices, tablets, computers and televisions."

It's a reasonable consideration. Nearly all Apple products can communicate with one another, including Macs, iPods, Apple TV, iPhones and iPads. The Android OS is now making its way into appliances, as well as tablets and media players.

The company's considerable mapping and location services division, which includes Navteq, is also feeling pressure from free services like Google Maps.

"With respect to digital map data and related location-based content, several global and local companies, as well as governmental and quasi-governmental agencies, are making more map data with improving coverage and content, and high quality, available free of charge or at lower prices," the report stated.

Nokia's Location & Commerce business also competes with companies such as TomTom, which licenses its map data and where competition is focused on the quality of the map data and pricing, and Open Street Map, a community-generated open source map available to users free of charge.

None of the information in Nokia's report to the SEC was unexpected. That the company has been treading dangerous waters for some time now is no secret. Investors took the news in stride. Shares of Nokia remained flat in early trading at \$5.10.

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