OPEN BOOK EXAMINATION **345**

Roll No....................................

Time allowed : 3 hours ***Maximum marks : 100***

Total number of question : 6 ***Total number of printed pages : 8***

NOTE : *Answer **ALL** Questions.*

1. **Case study :**

Merger and Acquisition in Changing Global Business Scenario :

On 3rd September 2013, Microsoft Corporation and Nokia Corporation entered into a joint venture (JV), whereby Microsoft Corporation (Microsoft) acquired all of the Device and Service business of Nokia Corporation (Nokia) through an all-cash deal. The Microsoft-Nokia JV was the 2nd largest merger in the history of Microsoft after the acquisition of Skype Technologies, the VOIP innovators, for $9.2 billion. The terms of agreement stated that Microsoft agreed to pay Nokia $4.99 billion for the Device and Service business and $2.17 billion for the patents, license and mapping service. Under the Device section, models such as Lumia, Asha and X series come under Microsoft's umbrella. Nokia device designs, accessories, supply chain employees, developer, supply relations and most of Nokia's manufacturing plants and testing facilities were now owned by Microsoft along with services like Mix Radio, Store and more. Nokia's Mapping segment was considered as a separate business and was excluded from the deal but Microsoft agreed to a 10-year licensing agreement. Microsoft had control over IP agreements and any third-party contracts related to Nokia's devices including Symbian along with Nokia's partnerships with Qualcomm and other silicon companies.

Microsoft acquisition of Nokia's Device and Service unit was a decisive strategy to develop a differentiated sustainable mobile force and overthrow the market dominance of Apple and Google in emerging smartphone handsets and device software industry. After the JV, Microsoft could work both on the firmware and software thus optimizing the process of design, manufacture and distribution of smartphones through Nokia's innovation technological expertise, consumer demographic data, collaborate marketing and branding skills. For Nokia, the deal was a strategy to safeguard its declining position in the rapidly growing smartphone market, strengthen its financial position and maximize the wealth of its stakeholders. Additionally, the divestiture of the handset would enable Nokia to concentrate on the non-phone business, including its HERE Mapping division, Noika solutions, Nokia telecoms group and nascent innovative technologies such as self-driven cars.

In 2015, a year after the acquisition, Satya Nadella, CEO Microsoft announced the writing down the the entire value of Nokia handset acquisition alongside sweeping job cuts. Microsoft's aim to challenge the market dominance. Apple and Google thought Nokia's acquisition culminated into a failure. The gross profit of Microsoft declined from 75% in 2013 to 69% in 2014 to 65% in 2015. The ROE (after Tax) declined from 28% in 2013 to 25% in 2014 to 15% in 2015. Profit margin of Microsoft reduced to 25% in 2014 to further 13% in 2015. The ROA changed from 15.35% in 2013 to 12.81% in 2014 and further dipped to 6.92% in 2015.

An Overview of Nokia

The Finnish company "Nokia" began its operation in 1865 as a single paper mill at Tammerkoski Rapids in south-western Finland. Over the years, Nokia has nurtured success in several sectors including paper products, rubber boots and tiers, cable, mobile devices and telecommunications infrastructure equipment. Nokia entered the Device and Telecommunication industry with the motto of "connecting people" through its cutting edge technology. As early as 1980, Nokia became a household name around the world with the launch of Nordic Mobile Telephone (NMT), world's first international cellular network with international roaming supported. The Nokia brand emerged as an undisputed leader in the mobile phone industry due the reliability, easy usage, higher resale value and durability of the devices. Nokia emerged as a multinational communication company engaged in the production of technologically efficient mobile products through innovation and convergence in the evolving ICT industry. The market capitalization of Nokia as of March 2nd 2016 is $22.61 billion. As of December 2014, Nokia has a employee base of 61,656 with the operating profit of $170 billion.

Nokia operated in major business segments namely-Smart Devices and Service, HERE (formely NAVTEQ) and Nokia Siemens Network. The Smart Devices targeted the smartphone segment while the Mobile Phone but worked relentlessly for providing reasonable mobile experience to the customers. The Device and Service segment controls the portfolio of product devices as well as internet services and applications. The HERE services had exclusive focus on location-based services and products. It also developed content-based services for automobile/device manufacturers, location-based application service developers, internet service providers, traders and advertisers. Nokia Siemens has global expertise in telecommunication equipment and infrastructures, hardware, software and services.

An Overview of Microsoft

Microsoft is the world's leading producer of computer software and is considered to be one of the most valuable brands in the world by Forbes magazine. Microsoft was incorporated in 1981, but it came into existence in 1975 when founder Bill Gates and Paul Allen saw an opportunity in operating system after the launch of Altair 800 (microcomputer) by an American electronics company known as Micro Instrumentation Telemetry Systems (MITS). Microsoft's major breakthrough occurred in the year 1981 when they developed on OS for IBM's first-ever entry into the personal computer space. Microsoft marketed its own version as MS-DOS (Microsoft

Disk Operating System). Microsoft became a dominant player in software market. In 1983, Microsoft introduced its first-ever OS with graphical user interface called Windows and since then it has been the most-used OS in the world.

Rationale of the deal

Microsoft acquisition of a part of Nokia's business was a strategic alliance where both the companies would work strategically to achieve common goals. Microsoft had nil to limited experience in manufacturing physical smartphone and needed strong technologically efficient manufacture to support its mobile software oriented benefits by collaborating with Nokia and developing a sustainable Windows Phone application ecosystem for long-term benefits.

Strategic Expectations of Microsoft

- Improving market share : Microsoft believed that the acquisition will help them accelerate its marketshare and profits in the phone market as millions of new users were waiting to buy a new smartphone. Before the acquisition, Nokia and Windows phone had more than 10% share in 9 markets and it was outselling Blackberry (then, a very popular company) in 34 different markets. Lumia phones had started gaining popularity and it believed that the imaging capabilities of Nokia could drive more success of them.
- Uniting hardware and software : Nokia had a very strong R & D division and had more than 30,000 utility patents and patents applications and around 8,500 design patents. Microsoft believed a synergy between a hardware giant and the software giant can bring revolution in the phone industry. The patents sector of Nokia was one of the most valuable in the tech sector.
- Benefitting from patents and royalties : Nokia had about 60 patent licences with many third-party OEMs which included wireless patents. Under this, Microsoft was also to benefit the attractive royalties.
- Strengthening its stance in tablet industry : Microsoft was already a leader in PC industry but was facing stiff competition in tablet industry. A smartphone success could have brought them success in the tablet business and that in turn could have helped their PC business and application environment.

Financial Expectations of Microsoft

- A much better profit per unit : Under the previous partnership, Microsoft was earning less than \$10 per unit and this earning had to support the entire marketing investment and platform payment support. But after the acquisition, a gross margin of more than \$40 was expected with a breakdown in 50 million smart devices.

- Impact on EPS : Microsoft predicted in its report that the transaction will be accretive by FY15 non-GAAP EPS and both GAAP and non-GAAP EPS in FY2016.25 Long-term value creation. According to a report, released by Microsoft, they expected a 15% market share in smartphone industry by 2018 with annual revenue of almost $45 billion. Also, predicted a $15 billion NPV with an assumed operating margin of 5% and a $30 billion NPV with an assumed operating margin of 10%.

Strategic Expectations of Nokia

Smartphone business reached a phase where the big players (Google and Apple) dominated the market with their strong ecosystem while the rest were either making losses or breaking even at best. At this juncture, Nokia had partnered with Microsoft. Leading business experts analyzed the rationale behind the deal from Nokia's perspective. They highlighted that Nokia aimed to regain its past glory of being a top player and hence was geared up to emerge as a leading player, through this deal, even in the smartphone business.

Risto Siilasmaa, Chairman of Nokia Device segment said, "What has now happened is actually the best solution of all the alternatives. I can't imagine any other realistic alternative where the company's future would look as bright as it does now."

North America was an emerging market for smartphone segment. Nokia wanted to establish its foothold in North America through its deal with Microsoft. Besides improved subscriber base, Nokia could use Microsoft's patents for its HERE services in return of making Microsoft the licensee of all its device and service related patents for a period of 10 years. Microsoft agreed to become 4 years paid licensee for the HERE platform resulting in the earnings of $2.18 billion for Nokia. Nokia would overcome the technical limitations of Symbian by opting for Windows OS patented by Microsoft for its upcoming portfolio of smart devices. However, as a trade-off, Nokia had to pay quarterly royalty to Microsoft based on number of Nokia phone devices sold, with a fixed minimum base fee.

After the acquisition, Nokia could focus on its business of making cellular networking equipment; it's HERE location-based services, and other innovative technologies which accounted for 50% of its sales in 2012. Finland would get a boost to its economy through Microsoft exclusive data center in Finland to serve European customers along with the investment of quarter billion dollar under the intent of future expansion of Microsoft.

There are a shift in the organizational leadership under which Stephan Elop stepped aside as Nokia's CEO to become executive VP of devices and services in Microsoft Corporation, while Nokia's Chairman Risto Siilasmaa served as interim CEO.

Financial Expectations of Nokia

- The ultimate objective of Nokia was to increase the revenue generation from Nokia mobile devices segment besides an increased market share under the global smartphone market.

- When the speculation about acquisition was made official by Stephan Elop, the share market responded positively by a rise of 38% in the market share of Nokia. The shareholder would get a return of $4.51 per share a per Euro-Dollar conversion rates in 2016. Nokia expected a sale of 53.7 million units in the quarter following the merger.
- "For Nokia, that is an important moment of reinvention, and from a position of financial strength, we can build or next chapter", said Siilasmaa, "After a thorough assessment of how to maximize shareholder value, including consideration of a variety of alternatives, we believe this transaction is the best path forward for Nokia and its shareholders."
- As a part of the deal, Nokia received a funding of 1.5 billion Euros from Microsoft in the form of convertible notes which Nokia could use at its convenience or pay back at the end of the deal.

Reflections of the Acquisition

Microsoft financials showed a steep decline after merger and acquisition. A write-off of $7.5 billion of goodwill and asset impairment charges related to phone hardware and $2.5 billion of integration and restructing expenses, primarily cost associated with Microsoft's restructing plans, which affected the overall business of Microsoft. The impact of the acquisition was so massive that even the gains in Microsoft's software business didn't compensate for the impairment cost of acquisition.

The objective of acquisition as stated by Steve Ballmer, CEO Microsoft, "We expect this acquisition to be accretive to our adjusted earnings per share starting in FY15, and we see significant long-term revenue and profit opportunities for our shareholders" failed to materialize even after two years of acquisition. The EPS reduced significantly from $2.58 in 2013 to $1.48 in 2015. The ROA of Miscrosoft reduced by almost 50% in the year 2015 as compared to 2013.

Acquisition of Nokia made Microsoft a true multinational brand as the clientele and manufacturing factories of Nokia expanded globally. The APAC region of India and China was maufacturing hub for Nokia but regulatory policies in China prevented Microsoft from controlling these manufacturing units. The India-based factory of Nokia was facing a tax dispute proceeding and hence remained as a part of Nokia after acquisition. The emerging markets were evolving technologically and moving towards 3G and 4G services for high speed data access on smartphones. The American markets were still recovering from the after-effets of the Lehman crisis and fluctuations in the exchange rate. Varying exchange rates made it difficult for Microsoft to arrive at a global pricing policy. The new markets lacked well-defined laws for the protection of intellectual property in terms of enforcement of copyright, trademark, trade secret, and other protections that apply to software and hardware products, services, business plans and branding.

Cultural integration of employees globally failed to turn out as expected by Microsoft thus posing a workforce threat. Microsfot laid-off 66% of the Finnish workforce from the Device and Service segment in 2014. The competitive landscape of smartphone OS comprised of Android, Apple iOS, Windows and others including Symbian (Nokia), Cyanogen (One+) etc. Open source OS (*e.g.*, Android), having low cost of production focused on price sensitive populous economies like India and China while premium OS (*e.g.*, iOS) focused no niche markets at premium pricing. Microsoft failed to position its product as compared to the competitors. The prime OS of Nokia "Symbian" was frugal in resource utilization and incompatible with object language C++ and Java. The technical limitation of Symbian and limited demand of Windows made Microsoft-Nokia based smartphones redimentary and obsolute in the competitive smart devices ecosystem. Microsoft owned or licensed limited patents of Nokia which excluded specific HERE-based patents and patents which were used for the clients of Nokia. The R&D expenses if Microsoft stood constantly at 13% of its revenue for the year 2014, 2013 and 2012.

The mergers of Sony-Ericson and Google-Motorola also exerted substantial amount of pressure on Microsoft to reinforce its strategies for the competitive smart device segment. However, all such mergers and acquisitions resulted in a dead fate.

The Way Forward

The recent 18,000 job cuts (12,500 from Nokia), restructuring charges of $960 million and impairment charges of $7.6 billion to Nokia Device segment by Microsoft gives a clear indication that the Microsoft acquisition of Nokia was a clear blunder. The prime reason behind such strategic collaboration is for the shared synergistic benefits derived by participating organizations. At the time of acquisition, Nokia was a downstream customer of Microsoft operating platforms (software) while Microsoft was the upstream supplier to Nokia's producct engineering and award-winning product design. There is an unwritten rule of thumb in M&A deals; Acquiring a profitable upstream supplier or downstream customer will not necessarily increase the profit of the acquiring company. Without some kind of synergy that make the acquired assets more valuable to the acquiring company than they are to be acquired company, the acquisition will not be profitable. So a discussion is warranted to analyze whether the Microsoft acqusition of Nokia resulted in success for Microsoft.

The prime intent for Microsoft behind acqusition was to push the usage of its signature OS "Windows" in the smartphone industry which is yet to materialize. Microsoft currently holds the market share of 3%-5% globally as compared to Android which stands at 80%. The MVA (Market Value Added) reveals whether Microsoft has succeeded/failed to maximize the wealth of its shareholder. At the end of Q4 of 2014, Microsoft's MVA stood at a little above $4 trillion. As per Q4 of 2015 released by the company, its MVA stood $3.6 trillion. This shows a reduction in the value of the company by $4 billion. The BEP (Basic Earning Power) ratio which stood at 16% at the end of Q4 of 2014 stands at 10% as on August, 2015 reflecting the fact that Microsoft is experiencing lower turnover ratios and lower profit margin in sales.

Referring to the above case, answer the following questions :

(*a*) State the theme of the case.

(*10 marks*)

(*b*) Discuss the concept of Mergers and Acquistions as a strategy for both the corporations.

(*10 marks*)

(*c*) Comment on the various implications relating to political, economic, social, technological, environmetal and legal factors.

(*10 marks*)

(*d*) Identify the internal and external factors that are favourable and unfavourable to achieve the objectives of merger and acquisition of both the units.

(*10 marks*)

(*e*) Evaluate the outcome of acquisition for Microsooft Corporation.

(*10 marks*)

2. (*a*) XYZ Co. Ltd. has been engaged in retailing business in UK. The Management of the Company has decided to extend the business of the company internationally. Initially, the Company started survey for Indian Markets and presented a plan for the expansion of its business in India through its outlets as well as through e.marketing route. Keeping in view of the global economic scenario and the international business policy of the Government of India, you are required to suggest the company's management to adopt the proposal or not.

(*5 marks*)

(*b*) JBL Co. Ltd. is an Indian Company engaged in courier services. It has commanding business in domestic sector. Now the company desires to enter in the global market for which it requires strategic alliance with US based company. Suggest the company for finalizing the strategic alliance agreement and also point out the advantages and disadvantages for the company if enters upon this alliance.

(*5 marks*)

(*c*) A company desires to establish its unit in a Special Economic Zone (SEZ) set up by the Government of India. You as an expert, advice the company in this regard highlighting the facilities and privileges which the company would obtain in the special Economic Zone.

(*5 marks*)

(*d*) Hudson Insurance Company is a US company desires to expand its insurance business in India under Foreign Direct Investment policy of the Government of India. You are required to suggest the company about the current FDI policy of the Government of India and other laws and regulatinos relating to FDI in Insurance sector.

(*5 marks*)

(*e*) ABC Exports Ltd. is planning to export readymade garments to gulf and European Countries. The company is anxious to know the financial feasibility of the proposal and also interested to know the various sources of finance for foreign trade. You are required to assist the company for conducting market survey and also to give a profile of the sources of export finance.

(*5 marks*)

(*f*) A company is planning to establish a manufacturing unit in a foreign country. The company is considering two options (*i*) Equity Joint Venture and (*ii*) Wholly owned subsidiary. Analyse these options and submit your report to CEO of the company.

(*5 marks*)

3. World Trade Organization (WTO) is constituted for facilitating the smoth conduct of International business. Several privileges are associated with its membership. Large number of countries of the world are the members of WTO. You are required to appraise the role of WTO is India's internatinoal business.

(*5 marks*)

4. A foreign food company is plannnig to make investment in Indian economy. As an international business consultant, advise the company to analyse the cultural environment of the country for the investment.

(*5 marks*)

5. Asian Development Bank (ADB) was established for poverty alleviation of Asia and Pacific. ADB has been driven by an inspiration and dedication for improving people's lives in this area. It is committed to help the member countries for improving its status by upgrading the standard of living of the people of the member countries. The main devices for its assistance are loans, grants, policy dialogue, technical assistance and equity investments. As one of the significant member of the ADB, evaluate its role in India's economic development.

(*5 marks*)

6. "The scope of logistics Management is not only optimising transportation cost." Comment on this statement. Also state the role of logistic management in international business.

(*5 marks*)

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