

Industry Briefing

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World telecoms: The China syndrome

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Savage cuts at Nokia Siemens Networks are another reminder of the growing strength of Chinese suppliers.

In an attempt to revive its flagging fortunes, Nokia Siemens Networks (NSN) will narrow its product range and cut its workforce by nearly a quarter. Every major western network equipment supplier has made big cost-cutting moves in recent years, usually involving heavy job losses, but the axe wielded by the Finnish-German joint venture is among the sharpest. In a bid to reduce operating costs by €1bn by 2013, NSN says 17,000 of its 74,000-strong workforce will go.

Since its founding in 2007, NSN has struggled to make a profit. Ericsson, the world's largest maker of mobile-network equipment, is a formidable opponent, and operators have been wary about splashing out on new network equipment ever since the 2008 global economic downturn. The most daunting challenge, however, comes from the international ambitions of Huawei and ZTE. China's two biggest telecom equipment manufacturers are not only aggressive on pricing, but operators consider the quality of their network gear on par with their western rivals.

True, Chinese suppliers have found it difficult to get a foothold in the US, but Europe, particularly for Huawei, is a happy stomping ground. Some of the region's biggest and most discerning operators—including BT, Telefónica, TeliaSonera and Vodafone—use Huawei equipment. What's more, both Huawei and ZTE are also strong in emerging markets, and fast-growing Africa in particular. Their advantage over western network suppliers is not only cheaper prices, but attractive financing deals to cash-strapped operators.

Leaner and meaner

NSN is yet to confirm which product lines it will offload as part of its restructuring programme, but carrier Ethernet (a way to send data over fibre-optic cables), its collection of entertainment solutions (including TV) and back-office software look the most vulnerable.

Where the company sees most value is mobile broadband and services. The bulk of NSN's R&D efforts will now be channelled to these two areas, playing to the joint venture's strengths. In terms of sales, NSN is the second-biggest supplier of mobile network equipment in the world. According to Ovum, a consultancy, NSN raked in US\$9.7bn of services revenue for the year to September. Of the services revenue generated by all network equipment providers (NEPs) during this period, NSN boasted a 20% market share. Only Ericsson performed better, claiming a 25% slice of the market.

Both mobile broadband and services look good bets for growth. With the volume of mobile-data traffic rocketing, thanks to a boom in smartphone sales, operators need to upgrade their existing third-generation (3G) networks in order to cope. Some have launched LTE networks, a "4G" technology. But NSN faces tough competition in this nascent market, both from the West and the East. According to the Dell'Oro Group, a market research firm, Ericsson enjoyed a 44% share of the US\$647m LTE market during the third quarter of this year, while Alcatel-Lucent took 30%. Both companies are benefitting from the extensive LTE rollouts underway by AT&T and Verizon Wireless in the US. NSN comes in fourth place behind Huawei, which, according to the Dell'Oro Group, had an 8% share of the LTE market.

NSN is not without some big LTE wins. Telekom Deutschland, TeliaSonera (Norway and Sweden) and South Korea's SK Telecom, use LTE equipment from NSN. But here, too, the Chinese equipment makers are starting to make inroads. Tele2 (Sweden), TeliaSonera (Lithuania) and Vodafone Germany, as well as an operator each in Poland and Singapore, have

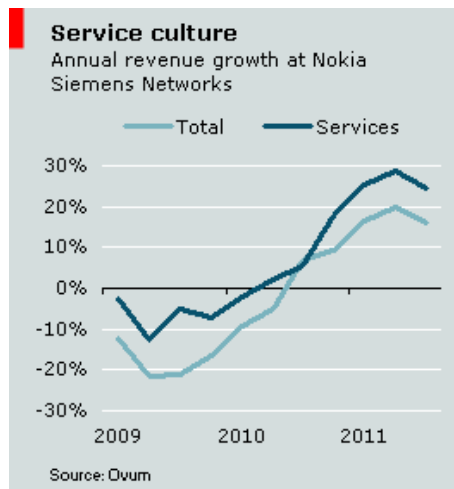
all launched LTE services using Huawei's equipment. ZTE is less prominent in the LTE network space, but has won plaudits from Hong Kong's CSL for its 4G equipment.

Making strides in services

On services, Huawei's market share is only around half of NSN's—11% for the Chinese firm versus 20% for NSN, according to Ovum—but it is catching up rapidly. Huawei started offering services as recently as 2005, ten years after market-leader Ericsson. Western NEPs typically argue that a long and trusted relationship with an operator is crucial to winning contracts to run its network, but Huawei looks to be gaining trust in short order. In Europe, the Chinese firm has already won services contracts in Germany (Telefonica O2), Spain (Jazztel) and the UK (Virgin Media).

NSN still has much to prove in services, despite its recent growth (see chart). Ovum expects the firm's services revenue this year to surpass its pre-recession peak, US\$8.7bn in 2008, by around US\$1bn. Still, the firm's rank in the market-share league table will remain the same, suggesting that it is simply riding market trends and not taking meaningful business from rivals.

Before the restructuring announcement, NSN was reportedly in discussions with private equity investors over the summer. A couple of months later, Nokia and Siemens felt compelled to pump €500m each into the ailing joint venture. Neither parent will rule out an eventual IPO, and the move to force more focus on NSN could be seen as setting the stage for a listing. In the meantime, rivals are sure to pounce on the perceived vulnerability of a competitor going through the gruelling process of shedding nearly a quarter of its staff. For NSN, things might get worse before they get better.



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