

Delving further into the financial ratios, Motorola's recent troubles become apparent. Gross and operating margins for Motorola are well behind the industry and sector averages⁴. Furthermore, management has not been efficient in utilizing its assets: the company's ROA is -1.51, while the sector averages surpass an ROA of 19. An -0.64 return on equity is equally worrisome in comparison to a sector average of 23.05. Inefficiencies and a failure to match the growth of its biggest competitors has led to low returns on capital, as return on invested capital has drastically been reduced from 30% in 2006 to a mere 4% in 2007.

Comparable Analysis⁵

	Motorola	Industry	Sector	S&P 500
Gross Margin (TTM)	27.17	49.22	52.48	43.92
Gross Margin - 5 Yr. Avg.	30.77	47.81	52.63	44.19
Operating Margin (TTM)	-1.51	17.22	19.25	18.82
Operating Margin - 5 Yr. Avg.	7.21	17.31	16.63	19.37
	Motorola	Industry	Sector	S&P 500
Return On Assets (TTM)	-0.29	9.32	12.53	8.69
Return On Assets - 5 Yr. Avg.	6.28	5.96	9.62	7.88
Return On Equity (TTM)	-0.64	15.63	23.05	21.07
Return On Equity - 5 Yr. Avg.	14.62	10.3	16.8	19.45
* Reuters				

development, sales and marketing forces, and advertising. It is essential for Motorola to continuously innovate in design and functionality if they want to remain positioned as an industry leader. Sales teams and effective advertising are also critical to appeal to consumer tastes and to establish prominent brand recognition. This presents a challenge to Motorola, as the company experiences rising production costs and declining sales. Companies like Nokia have streamlined manufacturing to cut costs, thereby allowing them to compete more aggressively on price. Motorola needs to either follow suit, or become a stronger player in the “designer phone” market.

Internal Rivalry: Home and Networks Mobility and Enterprise Mobility Solutions

The demand for Motorola products in this sector is increasing as cable and tel.com network operators expand their range of video, data, and voice services. Motorola competes in the global market, with a higher concentration of business in North America. This industry is highly competitive because of the rapidly evolving nature of communication and network technologies. Similar to the mobile phone market, economies of scale contribute to an industry structure consisting primarily of a small number of large firms. This structure necessitates competition on price as well as quality, including product and system performance, innovative technology, delivery time, reputation, and availability.

Motorola claims status as market leader in digital cable and IPTV set-tops in North America, which are devices used for entertainment systems. They encounter significant competition from Cisco, AARIS, Ericsson, and Harmonic, Inc. Motorola is a smaller player outside of the US market in this division, and competes with many smaller-scale electronic equipment suppliers abroad. The company is also a leader in cable modems in global markets. Their wireless network business is among the top in the world, but is behind Ericsson, Nokia-Siemens, and Alcatel-Lucent in size. Nortel, Huawei, Samsung, NEC, and ZTE are also major competitors in the wireless network market.

operates. Contracts may only lock customers in for a limited period of time, after which they are free to switch suppliers. If the supplying company, like Motorola, fails to meet expectations, the buying company may seek a competitor instead. However, if Motorola can meet expectations, a customer will be unlikely to go through the costs of establishing a contract with a different company. Anchoring may also be a factor for major customers who grow accustomed to doing business with the same supplier. A new entrant must therefore compete more aggressively on price or quality of their products and services in order to win over business from incumbent firms. Reputation and brand recognition may not be as important to these segments of Motorola as in *Mobile Devices*, since their products are not being sold to consumers who may base purchasing decisions on brand image. A reputation for quality, though, is important in these markets, and building a reputation may be difficult for a potential entrant. Motorola reports strong relationships with their customers, and it does not seem that new entrants pose a critical threat to Motorola's business in these areas.

Substitutes and Complements: Mobile Devices

Motorola's products face an array of close substitutes, and this can be seen in each segment of their mobile phone division. In the Mass Market segment, low-cost phones from industry leaders Nokia, Samsung, Sony-Ericsson, and LG are all close substitutes in price, quality of service, and types of features. Low-cost Chinese manufacturers are producing substitutes in the Mass Market segment for Motorola and for the industry as a whole. These phones, however, may not be viewed as close substitutes in the U.S. and Western Europe, where buyers are more brand-conscious. The next two tiers of Motorola phones, Feature and Multimedia, also face a plethora of close substitutes. Phones from the other top four wireless producers are comparable to the Motorola RAZR or MOTOROKR in sleek, compact design and multimedia capabilities. Substitute products in the Productivity category have been outselling the Motorola Q. The BlackBerry holds the most prominent market position in this class of wireless devices for business use, with the iPhone and devices from Nokia, Samsung, and LG providing similar features and services for both the business and consumer markets.

Opportunities

- Potential for international growth in developing markets, especially in the low-tier mobile device market in Taiwan and China
- Switch to silicon strategy could help lower long-term costs in Mobile Device division
- Growing demand for Enterprise Mobility Solutions products from foreign governments and agencies
- Capacity to adjust capital structures for each business after splitting of company
- Greater ability to focus on core businesses of each segment after split
- Increased flexibility of each segment following split
- Possible strategic partnerships and new campaign launches

Threats

- May face decrease in consumer spending for high-end handsets with potential economic recession
- Increasing market share for competitors (Nokia, Samsung, Sony-Ericsson)
- Intense competition across business segments
- Subject to currency fluctuations in foreign markets
- Local Chinese manufacturers gaining market share in Chinese mobile device market
- Inability to cope with loss of synergies with respect to infrastructure and back-office functions
- Potential inability to capitalize on switch to silicon-strategy
- Subject to unpredictable changes in consumer preferences
- Potential difficulty for *Mobile Devices* division to raise debt following spin-off

Strategic Issues and Recommendation

Originally, there were two main dilemmas facing Motorola amidst its declining stock price and plunging revenues for its *Mobile Devices* unit. Motorola, which is segmented into three business lines, has experienced considerable growth and profitability in its *Home and Networks Solutions*

other two profitable segments. These other segments, which are contract-based, have experienced sustained success not only domestically, but globally, through the acquisition of several key customers. The prospects of these businesses, including their profitability and long-term potential, are being hidden by the dismal nature of the *Mobile Devices* unit. Through the spin-off, investors would be able to assess the true value of Motorola's two successful businesses. While its handset business is a significant revenue source, Harkness Consulting believes management should seriously consider a spin-off. During the time of our assessment of whether the *Mobile Devices* segment should be spun-off, it was released to the press that Motorola's management team had decided split the Motorola company into two different companies; one would contain the *Home and Networks Solutions* and *Enterprise Mobility Solutions* segments, and the other would contain the *Mobile Devices* segment. Such a move was triggered by management's desire to unlock value held by the profitable businesses of Motorola.

Harkness Consulting's second analysis was aimed at creating a potential strategy for each of the new companies, following the split of Motorola. While the splitting of the company into two separate companies is scheduled to take place in 2009, our plan for the *Mobile Devices* business is to develop a strategy which would enhance the separate company's value both in the short-term, in the case of a potential selling of the business following the split and in the long-term to increase the future prospects of the company.

While the direction management is planning on taking with respect to the handset business is unclear, Harkness Consulting recommends the following strategy. As of now, Motorola has not announced a leader for the recently split *Mobile Devices* business. Without talented executives directing the operations of Motorola, the company will not be able to operate during this transitioning period effectively. There have been discussions to hire someone from within the firm to lead the handset business. However, Harkness Consulting believes outside talent is the better option for Motorola. Motorola's initial plan should include attracting top-level talent from other handset businesses such as Nokia by offering significant compensation in the form of stock options. With Motorola's handset business valuation expected to be low, the prospects

Appendix

Motorola Income Statements					
(in millions)	2007	2006	2005	2004	2003
	\$	\$	\$	\$	
Sales revenues	36,622	42,897	35,262	29,663	\$23,155
Cost of goods sold	<u>26,670</u>	<u>30,152</u>	<u>23,833</u>	<u>19,698</u>	<u>15,562</u>
Gross profit	9,952	12,727	11,429	9,965	7,503
Selling, general and administrative expenses	5,092	4,504	3,628	3,508	3,285
Research and development expense	4,429	4,106	3,600	3,316	2,979
Special charges	984	25	(404)	149	(34)
Total operating expenses	10,505	8,635	6,824	6,973	6,230
Operating income	(553)	4,092	4,605	2,992	1,273
Other gains and losses	<u>163</u>	<u>518</u>	<u>1,007</u>	<u>120</u>	<u>103</u>
Pretax income	(390)	4,610	5,612	3,112	1,376
Tax expense	<u>(285)</u>	<u>1,349</u>	<u>1,893</u>	<u>1,013</u>	<u>448</u>
Earnings from Continuing Operations	1,055	3,261	4,519	2,099	928
Earnings(Loss) from Discontinued Ops	<u>56</u>	<u>400</u>	<u>59</u>	<u>(567)</u>	<u>(35)</u>
	\$	\$	\$	\$	\$
Net income	(49)	3,661	4,578	1,532	893