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## ***ERICSSON – CALLING FOR HELP***

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## Abstract

The Dynamic Capabilities have been at the forefront of the recent Strategic Management theoretical debate, being one of the main theories attempting to explain how companies achieve a competitive advantage in a sustainable way. In contrast to previous approaches, this perspective directly addresses the concept of rapidly changing environments, something that past approaches did not include. In fact, it is the success of a firm in such environments that constitutes the main concern of the dynamic capabilities perspective. This dissertation intends to make a contribution for the consolidation of the DCs. To that end, it comprises a real-world teaching case that illustrates this perspective in practice and helps confirm its validity as a theory. The chosen business case is the Swedish company Ericsson (especially the SonyEricsson joint venture). It comprises a situation of a company in a rapidly changing industry, and aims at proving further evidence on the ability of the firm to address such an environment and thus significantly influence its performance. The case findings point to the fact that companies often fail to succeed if they lack dynamic capabilities, especially in dynamic environments.

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## Introduction

The Dynamic capabilities (DCs) topic has been at the forefront of the Strategic Management theoretical debate since the landmark article of Teece, Pisano and Shuen (1997) that first introduced this topic. Apart from the academic debates, the DCs are also likely to change the way in which entrepreneurs and managers view their role by addressing the question of the best way for their businesses to cope with changing environments (Barreto 2010).

The DCs draw from theories all the way back to Schumpeter, as its appearance in the strategic debates closely relates to the concept of rapidly changing environments. The origin of the DCs as a defined construct had already been approached before in several articles previous to 1997 - more significantly in Teece (1994). The DCs was seen as a response to three theoretical perspectives that attempted to explain the sources of firm's performance differences (Teece, Pisano, Shuen 1997). One of those perspectives was the Porter's competitive forces framework, which focused on firm's actions against competitive forces, and emphasized the importance of the industry choice in explaining performance differences (Porter, 1980). Another perspective was the strategic conflict approach (Shapiro 1989), with its main emphasis on game theory interactions. However, the new DC framework was mostly related to the third of those perspectives: the Resource Based View (RBV). This perspective, however, did not explain the reasons presented for the sustainability of the competitive advantage (Teece, Pisano, Shuen 1997). Striving to explain those reasons, the 1997 paper identified the concept of the DCs, a new efficiency-based approach. The DCs address the sustainability question of the firm's competitive advantage, and focus upon a Schumpeterian-inspired changing environment (Schumpeter 1942). This approach was based upon a more eclectic selection of areas like R&D management, product development and Human Resources, which will cause this new perspective to "not be included in the traditional boundaries of Strategy" (Teece, Pisano, Shuen 1997). The DCs definition contests the Porter's and RBV vision of the world as essentially stable (D'Aveni, Dagnino, Smith 2010) and marks an attempt to deal with a different external environment, one with constant and ever more frequent changes. Empirically, it was observed that nowadays is more difficult to sustain a competitive advantage than ever before.

Teece et al's (1997) DCs definition - "the firm's ability to integrate, build, and reconfigure internal and external competences to address regular changing environments" - suffered an evolution as, since then, several authors have attempted to develop it. Among the relevant additions to the definition, it is worth mentioning the contributions of articles such as Eisenhardt & Martin (2000) - "The firms process that use resources (...) to match and create

market change” - , Zollo & Winter (2002) - “(...) Pattern of collective activity through which the organization (...) generates and modifies its operating routines in pursuit of improved effectiveness” - and Helfat et al. (2007) - “capacity (...) to create, extend and modify resource base”.

While all these definitions were useful, the crucial problem of how to effectively define what makes the firms attain a sustainable competitive advantage in a changing environment was not properly addressed. In fact, these successive definitions were criticized in some articles for being somewhat vague. These critiques mainly focused on the tautological component of the definitions and the difficult operationalization of the concept, a crucial step in producing relevant empirical research (Williamson 1999, Kraatz & Zajac 2001). Barreto’s (2010) article provided an answer to some of these criticisms. Its main objective was to systematize conclusions gathered over a decade on this subject, and provide a more useful and operational DCs definition. The systematization was necessary to allow for more focused advances in future research, as the author considered the body of research left since the 1997 article “was very rich and diverse, but also disconnected and somewhat dispersed” (Barreto 2010). The new DCs definition offered what the author felt previous definitions had failed to, including an effort to distinguish “sensing, seizing and managing resources” as components of DCs (Teece 2009). The new construct was finally made up of clear, observable, relevant, operational and quantifiable categories, by identifying four dimensions: Propensity to sense opportunities and threats, propensity to make timely, propensity to make market-oriented decisions, and propensity to change the resource base (Barreto 2010). The debate was refocused, with implications in the theoretical discussion and in the way top management might deal with the problem of sustainability in their firms’ competitive advantages.

After defining the concept, a crucial step in its validation concerns the findings of empirical evidence. These serve as a confirmation of the relevance of the DCs, as well as providing ways to confirm if the theory holds its value in the real business world. This dissertation intends to provide such kind of empirical evidence – this will be the gap in my dissertation. In order to achieve that, I will use Barreto’s (2010) definition as the main theoretical basis, focusing on the four dimensions that compose the DCs and then apply them to the Ericsson case. The case will be focused on Ericsson’s long standing role in the mobile phone market, culminating on the ten years of joint venture with Sony. For more than a century, Ericsson was one of the most innovative companies in the phone industry and - after the 90s - in the mobile phone business; Ericsson was consistently responsible for many advances and commercial successes in the industry. A series of problems and shocks that began with the dot com bubble in 2000 and

ended with the emergence of the smartphones (epitomized by the iPhone) caused several decreases in the value of the company and eventually led to the end of its participation in the mobile phone industry.

How did the strategic decisions impact the company's performance and, ultimately, its exit of the industry? Can the DCs and its four dimensions be identified to explain those outcomes? This dissertation aims to contribute for a better understanding of the DCs in a rapidly changing market such as the mobile phones industry, while answering some of these questions through the facts collected about Ericsson.

The following steps of this dissertation are the literature review on the DCs, the teaching case, the teaching note, the section for Discussion section and, finally, the Conclusion's section.

## Literature Review

The seminal article of 1997 by Teece et al. provided the start of a growing flow of articles about DCs. Indeed, according to Barreto 2010, “the growing literature on this topic has provided successive and distinct definitions of the construct and shows the dynamism generated by the topic and is justified by the youth of the approach.”

The DCs approach is, indeed, fairly recent in the strategy debate focused on the issue of competitive advantage and how to sustain it. The question of what drives the good or bad performance of firms had already been dealt with a lot of different approaches that can be divided in two main types (Teece et al, 1997). For the first type of approaches, the main driver of the firm performance is the industry power. The Porter’s competitive forces framework was the most relevant model of this kind, placing a big relevance on the industry effect. It was dominant in the strategy debates for a long period of time, although several empirical studies (including by Porter himself) have later stated that the industry effect is not as important as the firm effect.

The second type of approach “emphasized building competitive advantage through (...) fundamentally firm-level efficiency advantages” (Teece et al, 1997) stemming from earlier discussions of corporate strengths and weaknesses, and evidence suggesting that advantages are built through efficiency and effectiveness (Teece et al, 1997). The dominant view in this case is referred as the Resource-Based view (RBV) that mentions “capturing entrepreneurial rents (...) from fundamental (...) efficiency advantages” as a mean of achieving competitive advantage.

What are, in fact, the main differences between the DCs and the RBV? The main difference is about the nature of the external contexts, i.e, where the theory addresses (or not) changing /dynamic environments. And what are exactly DCs? How can they be defined? That is still an ongoing debate. The first definition of the dynamic capabilities –“the firm’s ability to integrate, build, and reconfigure internal and external competences to address regular changing environments” (Teece et al, 1997) meant that they would reflect the ability of a firm to achieve a new status of competitive advantage in those kinds of environments having “path dependencies and market positions” as constraints (Leonard-Barton, 1992). This new definition had an enormous impact upon the strategic debate, leading to a huge number of articles looking upon the DCs and driving this concept forward, or just looking at it from a different angle. Different considerations of the DCs included the emphasis on the strategic use

of resources, defining the DCs as not merely routines but processes (Eisenhardt and Martin, 2000), and highlighting the “use of procedures and routines that help secure, manage and adapt those resources” and that “the antecedent organizational and strategic routines by which managers alter their resource base”. It is argued in favor of homogeneity in the DCs, spreading basic routines across firms – commonly defined as “best practices”. About the topic of heterogeneity in the DCs, they considered to be unique for each firm for its “path dependence, although there “are still more and less efficient ways for their execution” (Helfat and Peteraf, 2003). Also on this topic, other authors have defined the DCs as coming from different path processes (Teece et al 1997; Zollo and Winter, 1999).

Another definition of the DCs distinguished them from other capabilities classified as “zero-level or ordinary” (Zollo, 2003); in this paper, DCs would be a higher level type of capability that “modifies and creates the ordinary capabilities”, building upon a previous definition (Winter, 2000). In the same year, a paper draw attention to the importance of the management capabilities for defining the DCs, stressing the notion of “dynamic managerial capabilities”, that “reflect three underlying factors” (Adner and Helfat, 2003): managerial human capital - learned skills in education, training and even learning-on-the-job), managerial social capital (coming from social relationships between managers that confer influence, control, power, knowledge about own company and other companies internal and external ties) and managerial cognition (managerial beliefs and mental models that are the base for decision-making). As the years progressed, the theory kept expanding into new branches of strategy and, in 2006, Menguc and Auh focused on the market orientation and innovation of firms, and how these could be capitalized to create “firm-level dynamic capabilities”. Also, and developing past definitions by Hurley and Hult (1998) and Marinova (2004) it is mentioned that innovativeness is suitable for being that complementary resource that will turn market orientation into a DC; this is true as innovativeness implies that a firm has to be proactive by exploring new opportunities rather than exploiting current strengths (Menguc and Auh 2006).

Withstanding all this expansion, the new theory was soon criticized by several preeminent authors. Even before the 1997 seminar article the existence of a sustained competitive advantage in dynamic markets was seen as being unlikely (D’Aveni 1994). After the DCs were established as a construct, several critics soon followed. Williamson’s article (1999) criticized the tautological component of the concept, and its difficult measurement in an empirical way (Williamson 1999, Priem and Butler 2000) – which makes very difficult to empirically test it due to the vagueness of its definition (Kraatz & Zajac 2001). Another related criticism was that the concept did not pay enough attention to the mechanisms by which the resources actually

contributed to the competitive advantage (Williamson, 1999; Priem and Butler 2000; Mosakowski and McKelvey 1997). All this flow of research was very important in establishing the DCs as a major concept within the management discussion, stretching beyond the confines of strategy and starting to be applied to several practical areas of day-to-day firms' activity. Nevertheless no article had still quite managed to clarify in an unequivocal and operational way, what the DCs were, what they were composed of, and how they would eventually be measured and used in an empirical research. But amidst the debate, a new definition eventually emerged that attempted to decisively face the criticisms and provide the more operational approach many authors craved. In that paper, the author began by acknowledging all the previous research on the DCs, but admitting the main motivation for the article were the many successive definitions of the DCs that generated "some confusion" about the topic. Another reason mentioned was the lack of connection between all the research done up to that point "that lead in many different directions" (Barreto, 2010).

The new definition was "the firm's potential to systematically solve problems, formed by its propensity to sense opportunities and threats, to make timely and market-oriented decisions, and to change its resource base" (Barreto, 2010). The most important aspect in this definition is that it divided the concept into four smaller parts. And those smaller parts could actually be verified and measured: having more or less DCs could now be a quantifiable thing, making made the DCs a "multidimensional construct (...) of four distinct but related dimensions (...), an aggregate construct" – the four dimensions are not manifestations of the overall construct, they form it (Barreto, 2010); and they are also measurable individually; one enterprise may have more of one dimensions and less of another, as the dimensions between them can be poorly correlated.

Dividing the DCs definition in smaller parts was not original per se as Teece, in 2007, had already broke down the DCs in three parts - capacity to sense and shape opportunities and threats (sensing), seize opportunities (seizing) and "maintain competitiveness through enhancing, combining protecting, and (...) reconfiguring the business enterprise's intangible and tangible assets (transforming/managing threats). Teece went back to the origins of the debate, as the "sensing" originated from the entrepreneurship research that had been done up to this paper, drawing upon papers like Kirzner (1973) and Schumpeter (1934). His stated objective was to reconcile the theory with all the developments of the research in the past decade and at the same time providing some micro foundation for the theory. But that definition did not establish the nature of the construct, and some of its parts were hardly operational.

The definition by Barreto (2010) clearly states the nature of the construct (potential to systematically solve problems), separating from luck and ad hoc solving, as identified in articles like Winter (2003). Winter stated that companies could also rely on ad-hoc problem solving. It is clear that the DCs remain at the forefront of strategic management research theoretical debates, but Winter is just one of several authors questioning the actual validity of the theory in explaining the firm's performance. It is in this last debate that my dissertation can offer a contribution. For the purpose of applying and confirming the validity of the theory in the real business world, the Teaching case that will follow will be focused in a relevant company inserted in a very typical rapidly changing market – the ideal ground for testing the DCs.

## Teaching Case

### The recent troubles of Ericsson

The day was October 27, 2011. In a press release on its official website, Ericsson announced that “Sony will acquire Ericsson's 50 percent stake in Sony Ericsson Mobile Communications AB (“Sony Ericsson”), making the mobile handset business a wholly-owned subsidiary of Sony”<sup>1</sup> (in exchange for over one billion dollars). For Ericsson, the impact was much more than just the end of an 11-year joint venture with a reasonable degree of success on the global market: it was the end of Ericsson’s long standing participation in the mobile phone market – a market that owed a lot to Ericsson sense of innovation and technological resource base.

According to the statement itself, “the mobile market has shifted focus from simple mobile phones to rich Smartphone that include access to internet services and content”. Was this transaction a logical development given that evolution? The Ericsson CEO mentioned that “when we formed the joint venture, (...) combining Sony's consumer products knowledge with Ericsson's telecommunication technology expertise, it was a perfect match to drive the development of feature phones”<sup>2</sup>. This meant that the perfect match was no longer a reality, and it is easy to understand why, looking at some key figures. Ericsson’s share price and market value in the last decade had been very far away from the high values of the end of the 90s, when Ericsson was one of the very top companies in the mobile phone market – Exhibit 1. Even in recent years, the market share enjoyed by the company had decreased from 9% in 2007 and around 8% in 2008 to just 4% in 2009 and 2% in 2010 (Exhibit 5, 7 and 8). The company had more than 100 years of history in the industry and its partner in the joint venture was one of the biggest names in technology sectors. What had gone wrong for this participation to end? Was it just a strategic move to face the tougher times or was it the result of the decisions taken along the years in this market?

Ericsson was always present in many other markets besides phones – the company was and still is a big brand in broadband networks and connection capabilities. Nevertheless, many innovations on the mobile market were made by the company (including, ironically, the first ever phone marketed as a Smartphone, in 1999)<sup>3</sup>, and this market was regarded as a core business. For such a worldwide trusted mobile phone brand to suddenly leave that market all together takes something of importance. Let us now take a look at the history of Ericsson to try and make sense of all the changes that may have originated those unexpected developments.

The beginnings of the company and International expansion into the 20<sup>th</sup> century

The story of Ericsson begins in 1876. It was founded as a telegraph equipment repair shop<sup>4</sup> and named after founder Lars Magnus Ericsson. The founder looked at Alexander Bell's new technology and decided to start making phones at the image of Bell and Siemens products, the big pioneers at the time. Far from anticipating the huge international success that the company would have in the future, Ericsson started as the supplier of telephones and switchboards for Stockholms Allmänna Telefonaktiebolag – the first Swedish telecom operator. Although from 1878 Ericsson already made their own telephone equipment, the first real product innovation would only start a year later, when Lars Ericsson was hired by a Swedish company to adjust some telephones from the biggest international provider (at the time): Bell. Given his past experience with Bell and Siemens phones, he took the chance to further investigate possible additions and innovations to the phones. After improving the existing designs, Ericsson started manufacturing its own products in 1873 (and there was no patent problem, as all the used innovations were not patented in Sweden), and Ericsson soon became a major telephone provider for Scandinavia. This was the first real breakthrough on the innovative force Ericsson would eventually be in this industry.

Given the increasing competition, Ericsson would eventually partner with a new independent telephone operator in Sweden, later merging with it in the form of the *Allmänna Telefonaktiebolaget LM Ericsson*. An international expansion soon followed, with Britain being responsible for 28% of sales by 1897 and other British colonies being also important markets outside of Europe. At the turn of the century the company counted 1000 employees globally<sup>5</sup>, and it would even open its first US sales office in 1902<sup>6</sup>. One year before, Lars Ericsson had stepped down as the head of what was now becoming a true multinational.

In the following decades, the company turned itself into a household name in the communications sector, with a globally recognized brand. In the 20s and 30s, during the regulating efforts of the telephone markets by the governments, Ericsson further extended their geographical reach (i.e, several contracts with British national telephone company, one of their main foreign markets). During those two decades, the North-American ITT (International Telephone & Telegraph) multinational proved to be a global rival, but the company kept growing until the Great Depression.

The Great Depression of 1929 put a halt in the company's growth, in such a way that the level of success enjoyed by the company prior to it would not be replicated for a long time. And with the global reach of the company reduced, Ericsson also faced internal battles for control.

Having entered the Swedish stock market in 1918, the majority of the company was acquired by Karl Fredric Wincrantz in 1925. There were several struggles for the control of the company, including attempts at taking over by international rivals such as the aforementioned ITT (only prevented because of Swedish shareholding rules to protect home companies from foreign control), eventually resulting in the suicide of Wincrantz in 1932, broke and leaving the company in serious trouble. After some darker years, Ericsson survived and was saved from bankruptcy through several Swedish Banks. A key role was played by the preeminent Swedish banker family Wallenberg. After preventing the company's demise, the family progressively extended their control over the company until 1960, being still in a very strong position in the company until the present day - maintaining a big influence in management appointments and key decisions throughout time<sup>7</sup>.

Innovations at the heart of the company in the 20th century leading into 90s

Ignoring the growing trend in the 20s for the telephone exchange (i.e, with telephone calls that demanded an operator), Ericsson concentrated on producing and innovating on the manual phone, rightly seen as the future. A simple design was favored very early, giving in to demands of the mass production; Ericsson had its sights on being an innovator on a global scale. Progressively, and after the slower growth in the 30s, several important technological breakthroughs were made by the company, ensuring it would return to the top of the telephone industry, into the second half of the century; among other examples there were innovations like the first fully automatic mobile phone (1956)<sup>8</sup>, or even the first hand free speaker phones, all the way back in 1959.<sup>9</sup> As the company kept growing globally, the interest in diversification intensified, starting a trend of making many ventures with other companies. Along with the phone manufacturing, Ericsson was also a pioneer in the field of connections and network sectors. In fact, the broadband connections are still one of the core businesses for the company as of today.

But it was always in the telephone industry that Ericsson would make a bigger impact as a global brand. That industry was growing and changing fast: The mobile phone era arrived in the 90s and Ericsson, long known for its innovations in the field was quite naturally at the top from the beginning. Using the GSM (Global System for Mobile Communications) European communications standard for the mobile phones that were about to enter the market, Ericsson received its first order for these phones in 1988 (from Vodafone), with the first GSM phones being finally introduced in the market in 1991<sup>10</sup>. Throughout consecutive models,

many of the product innovations developed during the decade were made at Ericsson (see Exhibit 2 to see the evolution of Ericsson's phones in the 90s and until 2002).

The main market for the company was still radio communication (60% of sales), but in the middle of the decade the sales of mobile systems and phones had increased by more than 50 percent.<sup>11</sup> And the mobile phone market quickly became even more important, as the company soared into its best years ever, with the market value increasing dramatically. In just 5 years, from 1995 to 2000, the market capitalization exploded from 13 billion dollars to 113 (Exhibit 1) going along other big new technology names in "riding" the bubble that made many market values soar in the 90s; but it was also a reflection of the role played by Ericsson as a true giant in one of the fastest growing industries. At its height during the 90s, Ericsson held an (estimated) 35% to 40%<sup>12</sup> market share in the global mobile phone market, and developed a reputation for quality and reliability - drawing on a long established tradition going back to the early days of the company. In this decade, the main global competitor during the time was Nokia, another Scandinavian company that emerged in this decade as the global leader in the sector, and Motorola – also companies that saw their market values explode as the year 2000 approached (Exhibit 1).

The problematic transition to the 21<sup>st</sup> Century – the dot com bubble and the telecom crash

With the start of the new millennium Ericsson was established as a major global player, but the conditions were getting increasingly difficult. Its share of the global mobile phone market was estimated as being at the 9% in 2000<sup>13</sup>, already far away from its height in the previous decade.

But the position enjoyed by Ericsson in the mobile phone world would soon be challenged as the year progressed, with a number of major market shocks emerging in these years. First, the dotcom bubbles, causing a major re-shift in the new technologies companies. During the height of the bubble, almost every newcomer to the technology sector (especially internet based companies, as Internet was starting to invade the daily life of millions of people worldwide) would get overhyped on the stock markets and overinvested – even when supported by a weak or even non-existent business plan. The Internet seemed to be a safe bet, with the potential demand growing day by day. The bubble grew throughout the year of 1999 and then culminated in 2000<sup>12</sup> with the funding of many internet based companies that would reveal themselves huge failures. A large number of new internet based-companies made IPOs and became big all of a sudden. The value of these companies increased progressively to levels that were completely beyond their intrinsic value and, around 2000, the bubble burst.

The consequences were felt throughout the entire sector of technology based companies – not only Internet based ventures – and this bubble was shortly followed by a crash on the Telecom sector. There were several reasons for this crash: there was auctioning of the new third generation licenses for the mobile phone market that happened around 2000<sup>13</sup> in which the license sold were overpriced as governments sought to maximize gains; additionally there was a loss of confidence on the stock markets following the burst of the dot com bubble, as many investors wrongly associated the telecom companies with the “dot com” companies<sup>14</sup>. These events, connected with the economic downturn that happened around this period, caused what a British insurer called “the worst period of capital destruction in modern financial history”<sup>77</sup>. Historical telecommunication names such as Marconi (whose assets would eventually be bought by Ericsson in 2005), WorldCom, GlobalCrossing had to merge or suffer catastrophic financial consequences – many victims of failed investments on the new Internet companies associated with the global recession.<sup>15</sup>

Ericsson was not a dot com company but it suffered deeply as a part of the “telecom Crash” that followed the burst of the bubble. Ericsson’s market share that had already decreased by 2000 from its height in the 90s would continue to decrease over the following years. In January 2000, its market value decreased dramatically (Exhibit 1) to its 1995 value, even before the beginning of the bubble. The times were bad enough to led to the firing of 20000 of the 105000 employees worldwide in 2001<sup>17</sup> and 1700 in the next year.<sup>18</sup> In the same year, the company was now further from Nokia’s leadership than it had ever been (8% against 35% market share by Nokia)<sup>19</sup>. It got worse that just lost market share, as investors were suffering losses up to 2 USD Million and the stock went down by 95% at some point<sup>20</sup> – forcing the company to take the step of raising USD 3 billion from its shareholders. The company was in a dire situation and clearly felt it had to do something in order to maintain the position of leadership in what was now its main business of mobile phones.

Ericsson needed step up to the industry challenges and problems of capital as well as lack of investor’s trust that the company was under, and too much time (the whole of 2000 going into 2001) had already been lost after the shock. Additionally, the market was changing, and phones were now much more than just something to make a phone call: they were on their way to becoming the small computer we see today. During those days, it was crucial for companies to keep investing in improving the design and adding new features – and Ericsson was lacking the financial resources to their traditional expertise in phones. These reasons coupled together would bring about a need for enlarging the capabilities and resources of the

company. During that year, the negotiations with Sony would start in order as the best way for the company to face all these challenges.

The way of the crisis that led to the JV with Sony

Before going into the story of Sony Ericsson, one has to start by the short-lived alliance with Microsoft, the first major attempt at building an alliance by Ericsson, as it was clear the company alone lacked the resources and capabilities to remain at the top as its global share on the mobile phones dwindled. This alliance was announced on September, 2000<sup>21</sup>. On this day the new Ericsson Microsoft Mobile Venture was launched with the stated objective to “drive the mobile Internet by developing and marketing mobile e-mail solutions for operators<sup>22</sup>.” Therefore, the main purpose was to try and connect the mobile knowledge of the company with the internet possibilities. This shows some clear insight into the future by the two companies, as the importance of the internet on the overall mobile operator’s revenue is quite significant today. “Mobile e-mail should be as easy as talking on a mobile phone, which is basically what we will help mobile operators deliver to their customers<sup>23</sup>”, the alliance statement said in accordance with that view of the future. Moreover by combining mobility in communication and connection capabilities it clearly fit Ericsson's strategic focus. With all the potential, the alliance still failed. The vision seemed right, but Ericsson lacked the necessary resources to accomplish the ambition this alliance demanded and after just two years, the alliance ended. The alliance failed in trying to expand the Ericsson brand into the internet world with the “help” of a giant like Microsoft. The goal of the alliance was ambitious, but the company realized its core business was still with the mobile phones, a industry where its participation was in dire need of change.<sup>24</sup>

Ericsson was at a time of make or break a global mobile phone producer and it had one main advantage: the technology and competence at doing reliable, durable and well functioning phones was still recognized. But despite all the efforts of the company, the mobile phones were still regarded as just being functional. These phones had a good reputation for years, but it was clear that consumer tastes had changed. It was not enough for the phones to be reliable without taking into consideration its design and new modern features like the camera. This change was a challenge to Ericsson, which still lacked somewhat the entertainment and design capabilities (at least on its own) that would be necessary to succeed in the market of the new millennium. Additionally, while being very strong in the European market, Ericsson was trailing a lot in the American and especially the Asian market. In the meanwhile, Sony had been trying to get into the mobile phones market to get the most of their truly global brand (something

Ericsson lacked) and their big position in the Asian market (another Ericsson goal), but they lacked the technology knowledge on the phones, and its share market was around just 1% in 2000. In the midst of all the problems Ericsson was facing, there was a fire causing a huge loss at Philips that had become its single supplier of chips<sup>25</sup>. Philips was unable to provide the chips to Ericsson. Amidst rumors that Ericsson would sell its handset division, things were getting quite serious. Now, in addition to the problems mentioned earlier, Ericsson needed a new supplier, and again Sony could help – the need for the joint venture was increasing<sup>26</sup>. The match was as good as one could ask at the time, and both companies recognized in each other the potential to stretch their capacities, expand their capabilities and increase efficiency in their effort to be a major global player in face of tougher competitors.

In August 2001, the Ericsson mobile phones division finally struck a deal to begin merger to create Sony Ericsson, after several months of discussions<sup>27</sup> with the joint venture (JV) officially beginning in October 1st, 2001<sup>28</sup>. The stated objective was “to develop an alliance that would allow Ericsson to reduce spending on the costly development of next generation mobile phones at a time when many European telecom companies see their inventories piling up as the world's cell phone market is growing much more slowly<sup>29</sup>.” Cost issues were mentioned as one of the main reasons, but the real objectives on a longer term were to expand possibilities in the increasingly competitive and innovative market. A crucial part of the JV vision was to produce something “that could blur the line between communication and entertainment”<sup>30</sup>. That is, in increasing features and improving design and capabilities; these were now as important as the communications side. The kind of phones that provided the combination of communication and entertainment were already starting to be called Smartphones, still several years before Apple's iPhone. Combining Sony's consumer electronics with Ericsson's tech would be the answer to this new demand on the market: the first SonyEricsson models, starting in 2002, provided digital photography as well as other multimedia capabilities, and even emails and Internet.

The resource combination of Sony's consumer electronics expertise with Ericsson's technological knowledge in the communications sector was a very unique one, and SonyEricsson was perceived as having the capabilities to match Nokia and strive for the leadership in the mobile phone market, as the parent companies craved. The problem was that the alliance would only come almost two full years since the crisis had severely hit Ericsson, with competitors like Nokia limiting their losses in market share. The wasted time would be very difficult to recover.

SonyEricsson was responsible for bringing to their new phones key innovations like cheap camera phones, cross platform technology, operating system experimentation – the innovative sense still seemed to be there, in milestone handsets like the Sony Ericsson T610 in 2003, Sony Ericsson P900 in 2003, Sony Ericsson W800i in 2005, Sony Ericsson K800i Cyber-shot in 2007, and Sony Ericsson W910i in 2007 (Exhibit 3 shows some of these phones). These models managed to combine the sense of design brought by Sony with the reliability of the old Ericsson models. The crisis that Ericsson had lived in the beginning of the decade seemed to be over, as the company had a string of successful models in a growing market – although in profits and market share the company still lagged far behind Nokia –exhibit 2 and 3. But the market value had steadily improved since the beginning of the JV, although never reaching again the 90s values (Exhibit 1). At its peak in 2007, Sony Ericsson enjoyed a 10% share of the global mobile phone market and was the fourth largest phone manufacturer (Exhibit 5), returning to the same values of the end of the 90s. Looking at Ericsson’s share of the global profits of the main mobile vendors, it was also about 10% in 2007 (Exhibit 4).

In 2002, there was a new leadership that would eventually remain in charge until 2011. The new CEO was Michael Ternshaw, someone close to the Wallenberg family that still had a big role in the firm. The new management tried to expand the alliance strategy that seemed to work with Sony, aimed at diversifying the business areas invested by the company and better prepare Ericsson to compete in different technological sectors, which demanded different capabilities and resources. Eventually, the several attempted joint ventures (including LG and Marconi) would end without much of a truly positive impact in the company’ success as a whole<sup>31</sup>.

#### The dawn of the iPhone Era

With the 2006 K750i phone, SonyEricsson were attempting another push at Nokia’s market dominance and at the same time introducing a competitor for the growing mp3 sector, with the Walkman model phone – in fact, it never really broke the iPod dominance although it proved an ambitious effort. Even though Ericsson’s role of innovator was still acknowledged, some began to criticize what they saw as excessive similarities between many of the models around these years<sup>32</sup>, considering that the SonyEricsson had some unfulfilled potential to deliver a world-smashing product that eventually never came. And, worse still, products such as the Walkman and even the outstanding camera phones would be close to obsolete in just a few years. Times were about to change again, in ways that companies like Ericsson and Nokia

did not predict at all, being still concentrated on adding one or two new features on each new model.

It was the rise of the Smartphone era with the iPhone, although there were already several phones marketed as being “smart”. In the middle of the 2000s, companies like RIM (producer of the commercial smash Blackberry smartphone) had succeeded by including the Internet and several applications, as it was clear that the combination of Internet and mobility was the future. However, the new iPhone would take the smartphone concept to a whole other level that would change the rules of the market.

The day was January 9 of 2007<sup>33</sup>. The place was the annual Macworld convention by Apple. In front of a packed audience of Apple loyalists and many media personalities, Steve Jobs, the legendary CEO of Apple, is about to introduce what he calls “Apple revolutionizing the Phone industry”<sup>34</sup>. It was the presentation of the first iPhone. Jobs, with the iPod product line, had already completely changed the way people listened (and even bought) music, and in the meantime completely killing products such as the Walkman or even regular mp3 devices as the iPod became an iconic product. And this time, Jobs would take this a step further.

Jobs compared the iPhone with the existing smartphones on the market, by players like RIM (Blackberry) or Nokia. Smartphones already existed for several years, as Jobs mentioned, but he argued they could be improved; Jobs built an original product directed at improving the customer experience. What was the main difference of the iPhone? The whole package was completely original, and for the first time, it was not made as just a regular phone with some features on it. It made the best use of the strong Apple software and combined the use of music (with the integration of all the features previously available in the iPod line), phone and internet along with several applications that were significantly better than the competitors offer. Some of these features were not original but the product itself was of a totally different breed from the available options. The final touch was the addition of the touch capability; this was a completely original step giving an innovative edge to the iPhone greatly improved the consumer experience; it was so successful that the touch capability is today a feature of almost every Smartphone. Apple had never been on the mobile phone industry before, but the success was such that Apple still stands today as one of the main manufacturers of phones and it would help making the company the biggest in the world by market value in 2011, after its value exploded in the mid 2000s and especially after 2008 (Exhibit 6). This was something unthinkable just a few years before and arguably impossible without the iPhone.

The blueprint set by Apple was actually started by Ericsson by referring to their 1997 model GS 88 "Penelope" as a "Smartphone" for the first time ever<sup>35</sup>. The term was already there before the iPhone (i.e, with Nokia and Ericsson using the Symbian system in their phones) but the old-style phones were still dominant; the iPhone created its own demand out of, it seemed, almost nowhere - although the Blackberry phones did enjoy a run of success, until it greatly diminished in market share after 2007, like most other existing phones (in the case of RIM, down to just 14,6% of global market share in smartphones 2008 to not even appearing in the top vendors by 2012 – see exhibits 7 and 9). Instead of following the industry then-current practices, Apple took its know-how from previous successes and not before long dominated a market despite being a newcomer. And, crucially, the major success of the iPhone was soon followed by the clever employment of the Android system by Samsung to great success (eventual even surpassing Apple in total market share as of today). Indeed, in 2012, it was Samsung the first company to take Nokia out of the global leadership in mobile phone sales the company had held for so long (Exhibit 9).

Jobs came through with its promise of revolutionizing the phone industry, with dramatic consequences for Sony Ericsson, among other industry giants (Nokia, RIM). To confirm that it was indeed a revolution, let us look at some figure: from 2007 to 2011, Apple rose from a non-player to having an estimated 75% share of the profits of all the major mobile phone vendors, forcing the previous market leaders Motorola and Ericsson to negative profits by the next year and even Nokia from 2011 – exhibit 4. The market was now unrecognizable, with the old leaders and global brands on the verge of disappearing or being irrelevant. The smartphone went from a niche product to the mass market that we still see today (even surpassing global sales for older-style phones, in 2013).

Those companies proved to be unprepared for the new market conditions. After first downplaying the changes brought about by the iPhone, everyone would eventually attempt their own smart phones with touch capabilities. Xperia, first produced in 2008<sup>36</sup>, was the expected reaction by Sony Ericsson, after a huge decrease in sales experienced by the company in 2007 and 2008. Technically, it was a good product, but successive models fail to succeed as happened to the previous models before 2007. And the profits would continued to decrease for Sony Ericsson as a joint venture and for Ericsson as a company. Sony Ericsson was far from being alone the only former giant to fall in the mobile phone sector: Nokia decreasing in value abruptly (see exhibit 1), Motorola on the way to disappearing and RIM failing to respond to the smartphone revolution and come with another success like the original Blackberry. And given its importance for the company as a whole, it was clear that something

had to be done. In 2011, in its 10<sup>th</sup> anniversary of joint venture with Sony, Ericsson changed its CEO. At the time, many analysts predicted the end of the joint venture, seeing a brighter future for the company as being solely in Sony's hands – and making the best of opportunities like including the widely known PlayStation platform in their products (again trying to improve the entertainment side of the phone) as it had already been done with one of last SonyEricsson Xperia models<sup>37</sup>

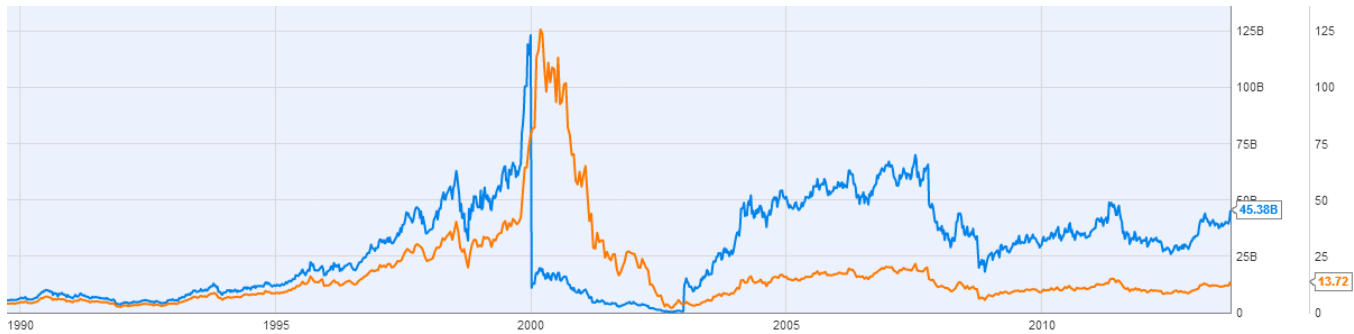
#### The end of SonyEricsson

In the end, it all went down to a simple fact: Sony Ericsson has not been able to keep pace with its best competitors. In the second quarter of 2011, its market share fell to just 2% and now ranking 11th in the list of phone manufacturers. As several analysts mentioned, the synergies of Ericsson technology and the strength of Sony brand that was envisioned for the JV, were only truly materialized in their products for a short period of years and, consequently, the recovery in market share was not to last long, especially after the iPhone. With phones being much more advanced following the introduction of the iPhone, the fact is that the technology and know-how that Ericsson brought to the JV was not as valuable as before. Moreover, with a serious financial situation for the company as a whole (including a failure to recover the lost market value since 2007 – Exhibit 1), it made sense for both companies to end the joint venture. Ericsson was leaving the manufacturing of phones altogether, the same industry it had started in since its foundation.

When the end of Ericsson's joint venture with Sony was announced, the new CEO said the decision made sense because although Ericsson was still seen as "a manufacturer of equipment", <sup>38</sup>the size of the software and service businesses made up 60% of the company – although he did promise not to leave the hardware business for good. That is, a company with more than a century of tradition in telecommunications and manufacturing of some of the most innovative and successful phones ever – a truly global brand and a symbol of Swedish technology – had given up that part of their history. Perhaps it was the right decision given all the problems it faced, but it remains to be seen what the future holds for this great 135 year old company.

Exhibits

**Exhibit 1: Ericsson Market Capitalization (and Share Price) compared with rivals Nokia and Motorola**



**Nokia Market Cap**



**Motorola Market Cap**



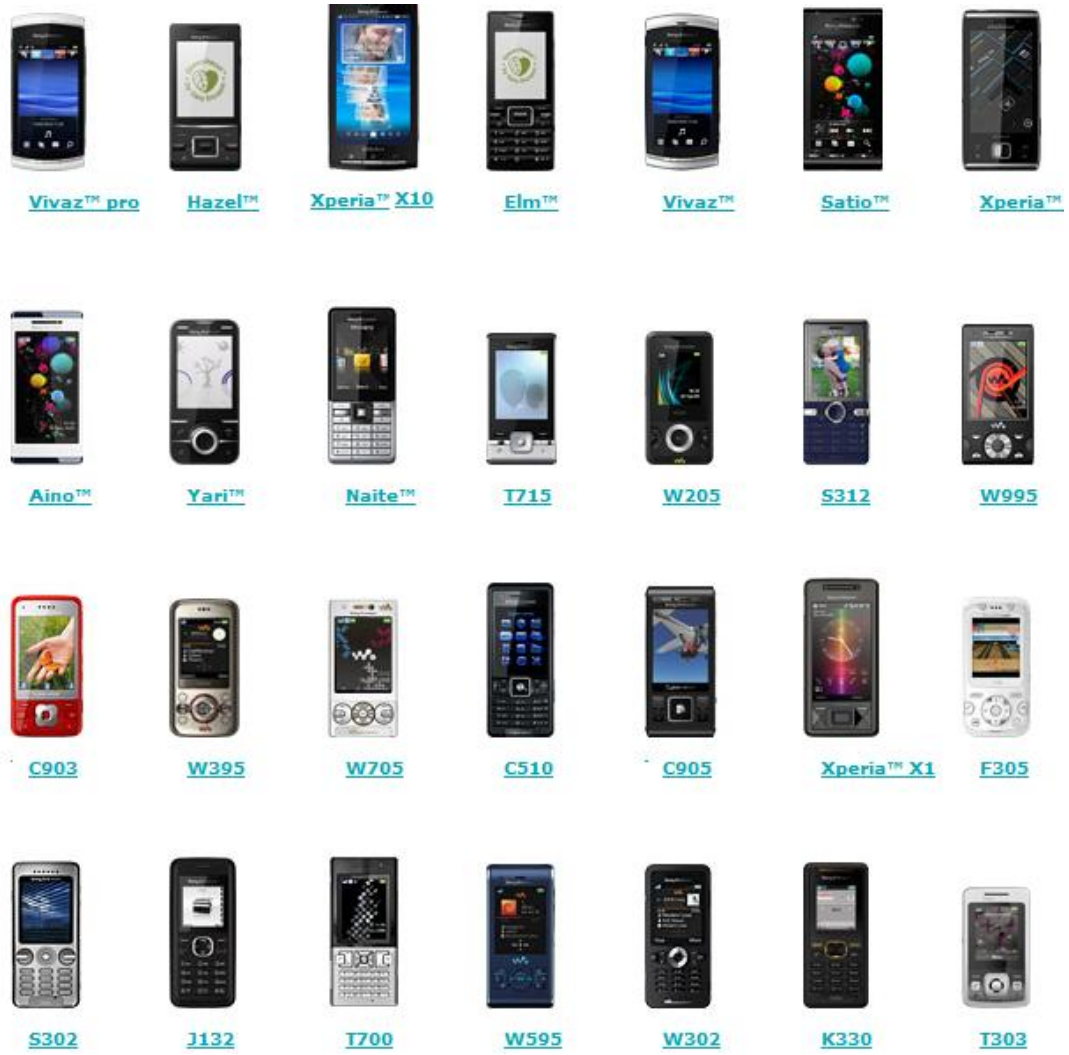
Exhibit 2 – Ericsson models in the 90s



Exhibit 3 – SonyEricsson models

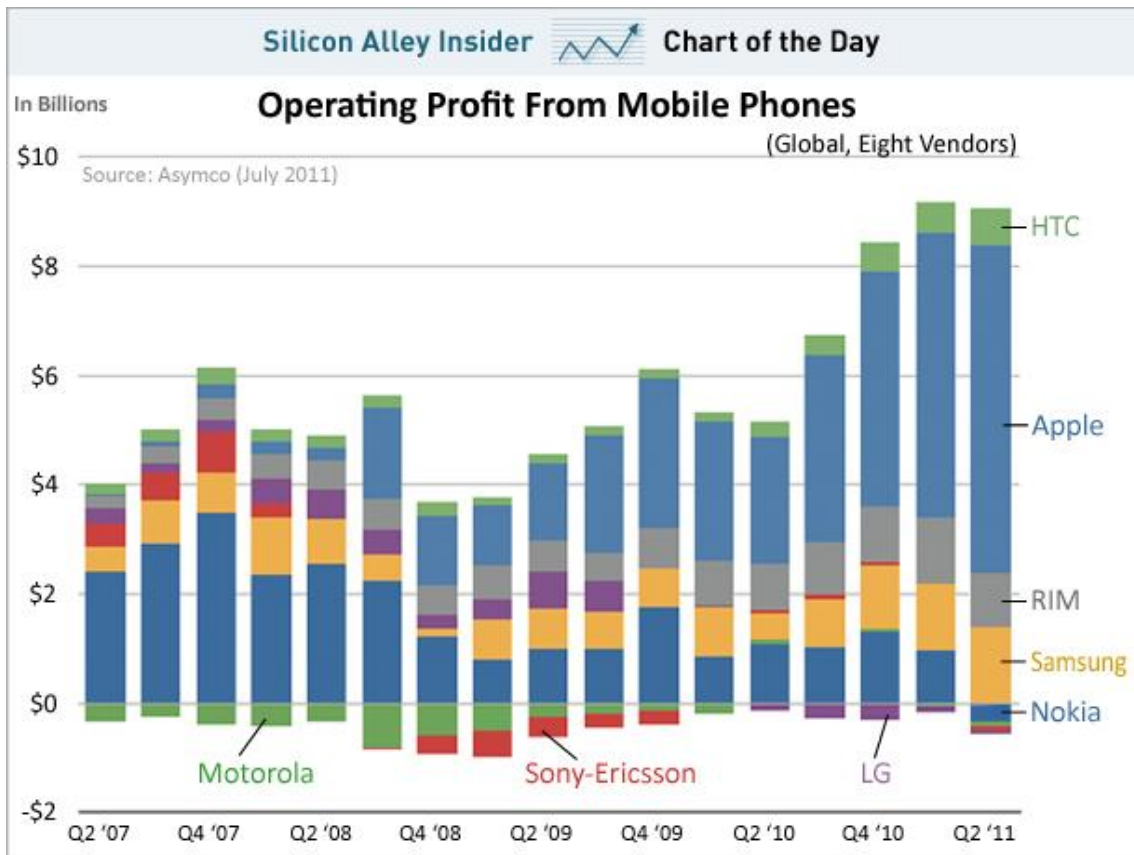


Some of the classic models of Ericsson in the 2000s

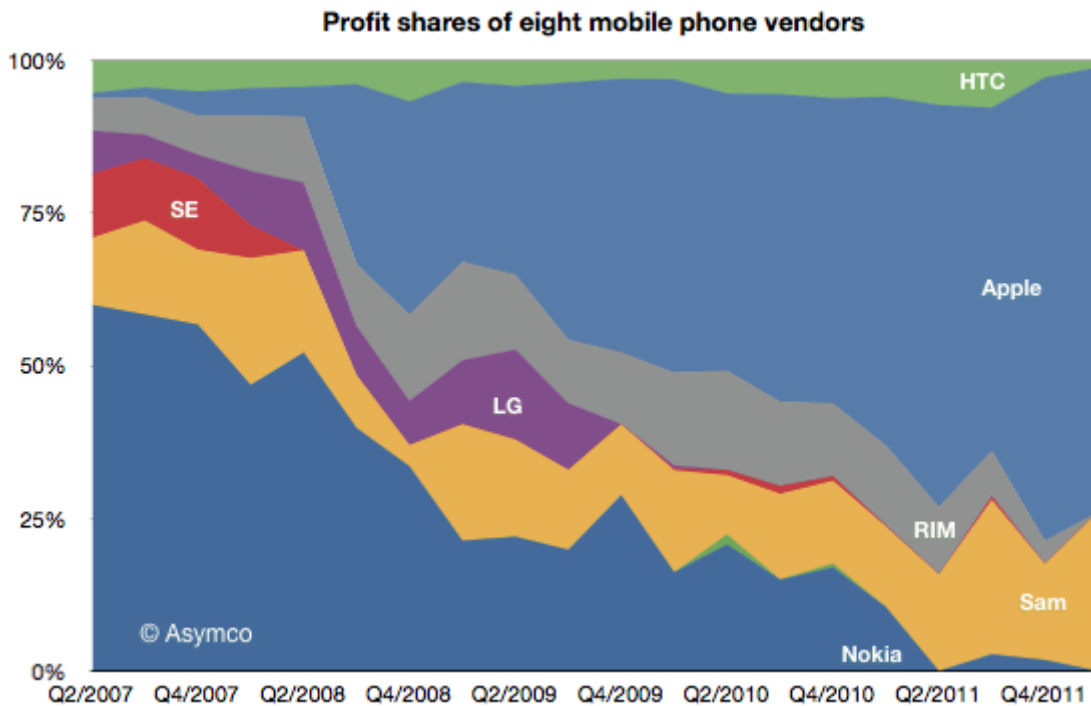


Some of the latest models produced by SonyEricsson

Exhibit 4 – Mobile Companies Operating Profits (graph 4a) and Share of eight mobile vendors profits (graph 4b) for the years 2007 -2011



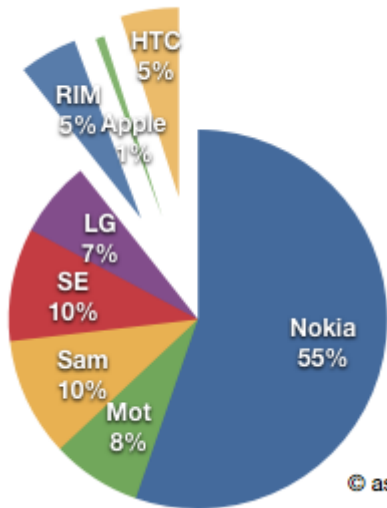
Graph 4a



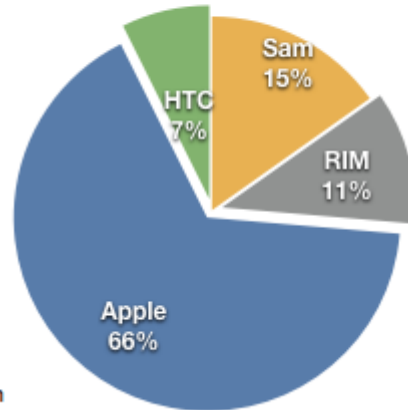
Graph 4b

**Exhibit 5 – Operating Shares and operating Profit shares for Mobile Phone vendors Q2 2007 compared with Q2 2011**

**Operating Share top mobile vendors Q2 2007**

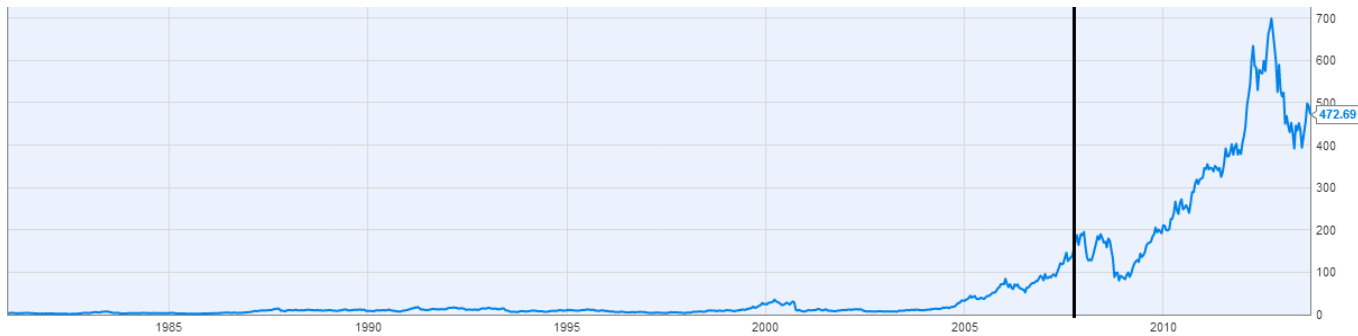


**Operating Profit Share top mobile vendors Q2 2011**



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**Exhibit 6 – Apple Market capitalization and the impact of the iPhone**



Marked in a black line, the data of introduction of the first iPhone

Exhibit 7 – Market Shares for Mobile Phones and Smartphones 2008 - 2009

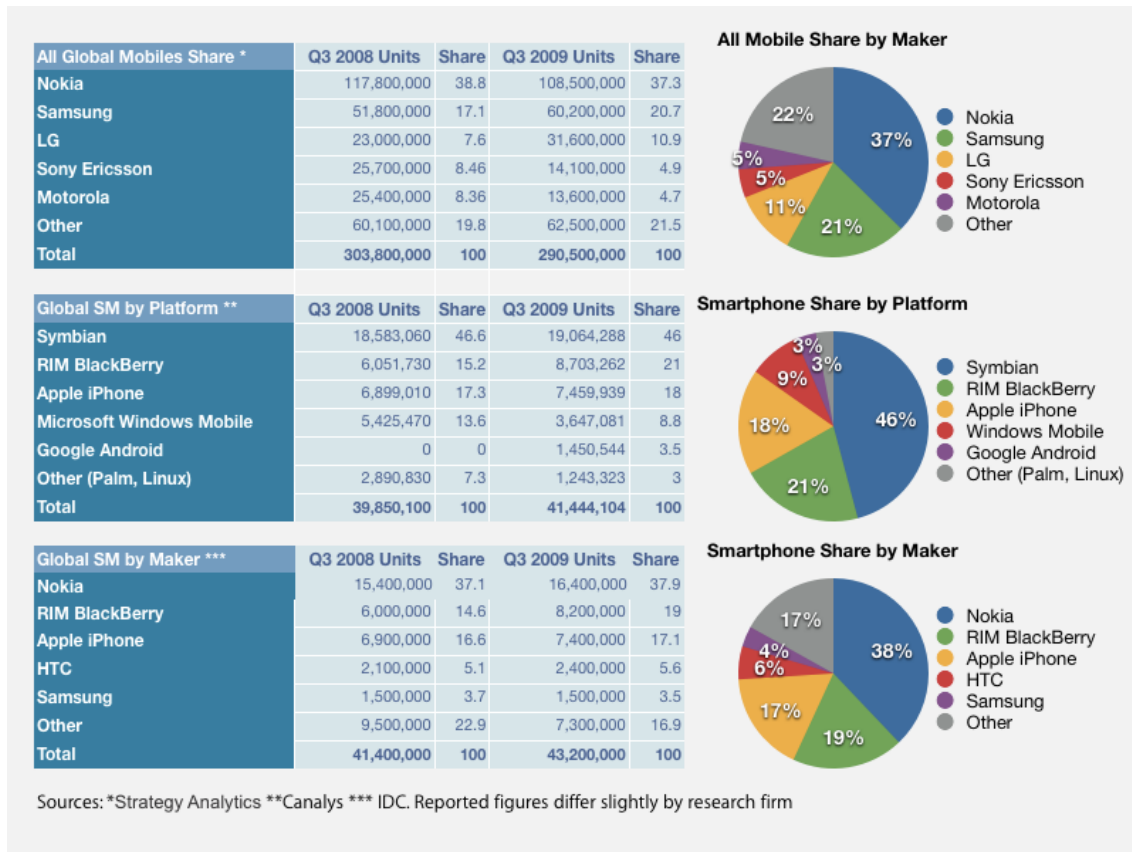


Exhibit 8 – Market Shares for mobile phones in 2009 and 2010

Worldwide Mobile Terminal Sales in 3Q 2010				
Company	3Q '10 Units	3Q '10 Market Share (%)	3Q '09 Units	3Q '09 Market Share (%)
Nokia	117,461,000	28.2	113,466,200	36.7
Samsung	71,671,800	17.2	60,627,700	19.6
LG	27,478,700	6.6	31,901,400	10.3
Apple	13,484,400	3.2	7,040,400	2.3
RIM	11,908,300	2.9	8,522,700	2.8
Sony Ericsson	10,346,500	2.5	13,409,500	4.3
Motorola	8,961,400	2.1	13,912,800	4.5
HTC	6,494,300	1.6	2,659,500	0.9
ZTE	6,003,600	1.4	4,143,700	1.3
Huawei Tech.	5,478,100	1.3	3,339,700	1.1
Others	137,797,600	33	49,871,100	16.1
<b>Total</b>	<b>417,085,700</b>	<b>100</b>	<b>308,894,700</b>	<b>100</b>

Gartner Research

**Exhibit 9 – Market shares for mobile phones in 4Q2012 and 2012**

**Table 1**

Worldwide Mobile Phone Sales to End Users by Vendor in 4Q12 (Thousands of Units)

Company	4Q12 Units	4Q12 Market Share (%)	4Q11 Units	4Q11 Market Share (%)
Samsung	106,957.7	22.7	93,830.3	19.6
Nokia	85,054.8	18.0	111,699.4	23.4
Apple	43,457.4	9.2	35,456.0	7.4
ZTE	16,160.6	3.4	18,915.1	4.0
LG Electronics	14,981.3	3.2	16,938.3	3.5
Huawei Technologies	13,679.1	2.9	13,966.1	2.9
TCL Communication	11,097.6	2.4	10,695.3	2.2
Lenovo	8,305.4	1.8	5,206.3	1.1
Sony Mobile Communications	7,946.6	1.7	8,935.7	1.9
Motorola	7,822.2	1.7	10,075.3	2.1
Others	156,613.7	33.2	151,985.1	31.8
<b>Total</b>	<b>472,076.4</b>	<b>100.0</b>	<b>477,703.0</b>	<b>100.0</b>

Source: Gartner (February 2013)

**Table 2**

Worldwide Mobile Phone Sales to End Users by Vendor in 2012 (Thousands of Units)

Company	2012 Units	2012 Market Share (%)	2011 Units	2011 Market Share (%)
Samsung	384,631.2	22.0	315,052.2	17.7
Nokia	333,938.0	19.1	422,478.3	23.8
Apple	130,133.2	7.5	89,263.2	5.0
ZTE	67,344.4	3.9	56,881.8	3.2
LG Electronics	58,015.9	3.3	86,370.9	4.9
Huawei Technologies	47,288.3	2.7	40,663.4	2.3
TCL Communication	37,176.6	2.1	34,037.5	1.9
Research In Motion	34,210.3	2.0	51,541.9	2.9
Motorola	33,916.3	1.9	40,269.1	2.3
HTC	32,121.8	1.8	43,266.9	2.4
Others	587,399.6	33.6	595,886.9	33.6
<b>Total</b>	<b>1,746,175.6</b>	<b>100.0</b>	<b>1,775,712.0</b>	<b>100.0</b>

Source: Gartner (February 2013)

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## Teaching Note

### Synopsis

Ericsson was founded in 1876 and right from the start it distinguished itself by bringing the most recent communication innovations to Sweden. At the dawn of the 20<sup>th</sup> century, it was a major phone manufacturer for Scandinavia and with a presence in other markets as well. Its innovative sense got the company through tougher times in the 30s and after being rescued from bankruptcy the company would concentrate on developing models for manual phones. Ericsson developed the first fully automatic model, and it established itself as a truly globally known brand from the 60s onward, in phones and also other related markets. Ericsson created one of the first mobile phones to be sold and, in the 90s, the mobile phones became flagship products for the company. Supported by several very successful models, Ericsson was a major player in the market, along with another Scandinavian giant, Nokia.

But times would soon change, and after the big shock in the communications sector caused (partially) by the burst of the dot com bubble (with the burst occurring around 1999-2000) and the recession that followed, Ericsson had to lay off many workers and their investors lost a lot of money. Losing ground on its main market of the mobile phones and in a dire financial situation, Ericsson would eventually partner with Sony with the objective of recovering its position as a major player in the mobile phone market. The goal was to create synergies by combining the technological know-how Ericsson possessed with the strong brand and design ability brought by Sony. Sony also could bring strength in markets still unexplored, such as Asia. The alliance was made in the end of 2001 and its vision translated to a series of models from 2002 and 2007 that followed the global trend of adding more and more features to the phone, like internet access and camera – phones were much more than communication tools and entertainment was beginning to play a big role.

This was the beginning of what was called the Smartphone. A concept already approached by Ericsson and companies like Nokia and RIM (Blackberry), it would herald the second big shock for Ericsson, when Apple – coming off its hugely successful music revolution with the iPod – built a very advanced phone (compared to the alternatives on the market) combining touch capabilities, music, internet and application supported by a far superior software. All of the sudden, software became a big deal and with the unique sense of design of Apple, the product was a smash. Soon followed by companies like Samsung and other Asian ventures, the

traditional communication companies like Ericsson lost a lot of value as their products were soon obsolete in what was an even more dynamic market than before.

SonyEricsson would try to respond with its own new Smartphone line, but they never recovered its position enjoyed in the middle of the 2000s (even less recover Ericsson's share in the 90s). It was clear that it would be a burden for Ericsson to still be in a business that was not delivering enough value. When coupled with the serious financial difficulties the company was facing again, it proved too big a challenge for the company. In 2011, Ericsson sold its patents and position in the alliance to Sony, and left for good a business in which it had been an innovator and pioneer for more than a century.

This case examines how one of biggest pioneers and brands in the global phone industry was forced to leave the industry altogether 10 years after having been "forced" to setup an alliance in order to stay competitive – a company that had all the necessary technological know-how to produce the best products but was unable along the way to respond on time the changes in customer taste in a very dynamic competitive environment.

The first section of the case describes the end of the joint venture with Sony and of the manufacturing of mobile phones, with the new CEO admitting that Ericsson had been left behind by the evolution of the market. The rich tradition of the company in the phone sector is also acknowledged, in order to demonstrate the big significance of the end of SonyEricsson for the company as a whole.

In the two following sections, the history of the company is described with an emphasis on its phone business. The second section is about the foundation of the company as a phone manufacturing company that soon became international. It further documents the first decades of the 20<sup>th</sup> century, the growth (both domestically and international), and also more difficult times and big competitors that emerged and caused the first big crisis for the company. It is also documented how that crisis was resolved and bankruptcy avoided with the help of the Wallenberg family that would eventually dominate the company until today. In the third section, the big role of Ericsson as innovators on a global scale for the phone market is recalled, as the many breakthroughs in terms of new products along the 50s and all the way to the 90s (with the first mobile phone ever) caused the company to have a very strong position as a mobile phone manufacturer in the last decade of the 20<sup>th</sup> century.

The fourth section is it describes how the global communications market was struck with successive shocks related to the bursting of the so called dot com bubble and also the

telecoms crash that followed it. The specific consequences for Ericsson, that faced many problems, are also mentioned.

The fifth section describes the way out of the major problems Ericsson faced. First, with the short-lived attempt at an alliance with Microsoft that would explore the connection of mobile phones and the internet. Then, the main reasons that eventually lead the creation of Sony Ericsson, and why most analysts and parent companies considered that both companies would be a perfect match for each other in attempting to re-conquer the share on the global market Ericsson had in the 90s and even extend it to regions like Asia. It further describes the strategic decisions by SonyEricsson and its translation into the successive new models that came out at this time, resulting in a clear improvement for Ericsson after the very troubled entry in the new millennium. The peak in terms of market share in 2007 is mentioned at the end.

In the sixth section, a second big shock for the market is described with the rise of the iPhone as disruptive blockbuster in the market. With its enormous success, it created a new phone giant in a company (Apple) that had never previously been in the phone industry. It was the dawn of the Smartphone era, and with other software companies like Samsung soon following, the traditional dominant powers like Ericsson and Nokia suffered a lot – as it became clear that the resource pool that a company like Ericsson had was not sufficient for the new age.

Finally, the seventh section is about how the new leadership of the company understood that the presence of Ericsson in the mobile phone market that used to be its main business was not anymore creating enough value – and it was demanding different resources from what the company had. Sony realized the same, and the alliance finally and naturally came to an end.

#### Teaching purpose

The Ericsson case is aimed at students with at least a basic understanding of Strategy. It is intended at being taught in Undergraduate or Master courses related to Business Administration or Strategy. The phenomenon described by the case is one consistent with the dynamic capabilities theory that attempts to explain the maintenance of competitive advantages in dynamic environments – such as the telecommunications sector of which Ericsson was an household name for a long time.

The case requires students to:

- 1) Identify and explain the main changes that occurred in the mobile phone business since it came to prominence in the 90s;

- 2) Explain the rationale behind Ericsson decision to enter an alliance with Sony (especially having in account the need for change in its resource base);
- 3) Evaluate how the initial strategic vision for the alliance was actually translated into market success, at least for a while;
- 4) Understand the relation between the radical changes the mobile phone market went through and the need for change in the resource base of its major players; explain the main factors behind the major market success of the iPhone.

#### Intended contribution

The main purpose of this case is to illustrate the importance of the key strategic decisions taken by the management on the results that would eventually follow. The identification of the four main dimensions of the dynamic capabilities as according to Barreto's (2010) definition should be easily undertaken by using the chosen teaching case. The final outcome of this case was highly influenced by the timing and the "fit" to the market conditions that the strategic decisions of the company had; other important factors for that outcome were the degree of Ericsson's capability to sense opportunities and threats as well as to change the resource base.

This case is very suitable to the purpose of identifying those dimensions and to test the dynamic capabilities theory given the fact that the company was inserted in a rapidly changing environment, and it was a good example in which the strategy of the company was forced to change quite a bit during a relatively short period of time. Because the company no longer competes in the phone market altogether, it is a good example to explain that what went wrong had a lot to do with the DCs concept. The case renders clear that Ericsson was completely unable, alone or in the alliance with Sony, to keep its leadership position in the global mobile phone market – eventually having to leave its flagship business.

#### Instructor's preparation

For the instructor's better preparation, it is advisable to have a good insight on the supporting theory of this thesis, the Dynamic Capabilities view. I would suggest the reading of the article "Dynamic Capabilities: A Review of Past Research and an Agenda for the Future," (Ilídio Barreto, Journal of Management, January 2010), as it not only provides a very encompassing literate review of the main articles on this subject, but also provides a definition that was one of the key point in this teaching case – namely the four proposed dimensions for the dynamic capabilities construct. This article would also be helpful for the students' preparation.

About Ericsson, it would be advisable to read some of the more recent reports of the company, and its website, which provides a quick resume of the history and main products of the company (some of which have been mentioned in the teaching case). It would also be interesting for both the instructors and students to watch the 3-minute YouTube video “The end of Sony Ericsson - A look back at its 10-year history”. It was made just a year before the end of SonyEricsson and quickly summarizes some of the issues discussed made in the teaching case. In what concerns the shock constituted by the appearance of the iPhone and the dawn of the Smartphone, I would suggest watching the YouTube video “Steve Jobs' Best Video Moments on Stage (2/3)” – it shows the famous conference that launched the iPhone, a turnaround point in the revolution of the mobile industry caused by Apple. It would also be a very useful material to use in the students’ discussion after reading the case.

As an additional reading, some of Ericsson press releases mentioned in the end notes of the case, especially the ones concerning the beginning and end of SonyEricsson would be advised to give a greater insight of Ericsson’s strategy concerning the joint venture with Sony.

#### Suggested Assignment Questions

- 1) Identify and describe the two main exogenous shocks that affected Ericsson (and SonyEricsson) performance in the mobile phone market.

The students should be able to identify that the first main exogenous shock took place in 1999-2000 with the burst of the dot com bubble coupled with the telecom crash that followed. This was coupled with the changes in customer tastes that meant phones were now becoming more than just communication tools, with the entertainment side and the design (capabilities Ericsson in which was not specialized) coming to the forefront. The combination of the two effects was crucial in leading the company to form SonyEricsson, as a way to respond to the crisis and on the other hand enlarge its resource base for the next years.

The students should also identify that the second shock occurred in the years following 2007 with the release of the first iPhone by Apple that brought on the beginning of the Smartphone age.

Further to the shock’s identification, the students should describe its respective role on bringing major change for the market conditions Ericsson faced. In the first shock, many telecommunication companies faced two combined effects: the dot com bubble that led investors and stock markets to suddenly stop investing in new technology

companies after the debacle of many “dotcoms” (wrongly assuming they were similar to all the new internet ventures who had close to no business plan); equally important, the overvalued amounts paid for new 3G licenses across the world; finally, the recession and capital dearth that followed.

The second shock had a more direct impact on Ericsson market environment, as well as other mobile phone giants, as it completely changed the rules of the industry, by proving a completely original product that soon made all the previous models obsolete. It would soon force all these major companies to follow Apple’s lead. The software requirements that people expected in their phones were at a much higher level than most companies could deliver – and they could not even match the sense of design that electronic giants like Apple and Samsung would deliver.

In just some years, the companies that had dominated the market for the longest time (Nokia, Motorola and Ericsson) were, respectively:

- Facing serious difficulties in keeping its profitability (Nokia)
- Sold to an electronic giant, Google, mainly interested in the patents hold by the company (Motorola)
- Out of the mobile business (Ericsson).

From a combined market share of 54% in 2008 for Nokia, Motorola and Ericsson, they went to just a bit over 32% in phones by 2010 (and just 4.5% for SonyEricsson and Motorola combined). And Nokia would follow suit with just 18% in 2012 after having more than 50% by 2007, just 5 years earlier (see Exhibits 5, 8 and 9). The effect of this second shock was no less than dramatic.

- 2) Taking into account the four dimensions proposed by Barreto (in “Dynamic Capabilities: A review of Past Research and an Agenda for the future”) for the dynamic capabilities construct, please apply them to describe Ericsson’s strategy to the two main exogenous shocks identified in the previous answer.

The first step would be to identify the four main dimensions defined by Barreto (2010) for the new dynamic capabilities construct. Those are the following:

D1. Sensing opportunities and threats

D2. Making timely decisions

D3. Making market-oriented decisions

D4. Changing the resource base

Next, I will apply each of those dimensions to the Ericsson case.

First shock – The combined effects of the dotcom bubble and telecom crash that followed (1999-2000)

D1: In the first shock, Ericsson failed to sense the threat posed by the overvaluing of the dotcom bubble; and, further, it would fail to immediately see the big opportunity posed by the shift in consumer taste for phones that were much stronger on the design and the entertainment side (i.e, by increasing many features as Motorola and Nokia were already doing at the time). The company was faced with a dire financial situation, but it was very reactive throughout these years, and consequently would never recover again its role as a true dominator in the industry, as it had before the shock.

D2: Ericsson lost a lot of time by trying in vain to form an alliance with Microsoft, when their priority should have been the rebuilding of the company and recovering of the market share. The market value of Ericsson declined critically in January 2000 and from there on the company financial condition and market share kept decreasing; even recognizing that there was a need for a resource base change, the timing was very bad, as it took almost two years for the joint venture with Sony to be finalized. It is arguable that some of the market share they lost could have been avoided with a more swift response. Ericsson went from almost 10% market share in 1999-2000 to about 4% two years later, and with its market value recovery taking much longer than Nokia – see exhibit 1 and relevant endnotes.

D3: In the first years of the SonyEricsson alliance, they came up with products that went in the way of the market: phones with a lot of features and adding more features and internet capabilities with each model. The joint venture's good job in market related decisions was an important factor for allowing Ericsson to recover from the crisis and regain a reasonable global market share, even if not truly threatening Nokia's leadership.

D4: This dimension was also a crucial point of this shock. The main reason for Ericsson to look for an alliance after the 1999-2000 crisis was precisely because the management understood that in order to face the new adverse condition and succeed in new markets, it had to find new resources outside the company – resources like

sense of design, experience in consumer electronics and even brand power in a true global scale. The answer to this need for new resources was mainly found through alliances with companies like Microsoft, for the internet connections and, crucially, especially, Sony for the mobile phones. After the first shock, the ability to change the resource base was there, a key contribution behind the recovery of the market position that the company would enjoy.

Second shock – The Smartphone era beginning with the introduction of the iPhone (first iPhone introduced in 2007)

D1: In the second shock, this dimension was one of the main issues. Ericsson (and all the other industry giants) failed to see the true potential of the Smartphone and could not sense the threat that a company like Apple would be able to constitute. Using the Symbian model and trying to build a superior phone around it would not be easy, but if the threat had been sensed by the management, it could have been turned into an advantage by any of the mobile industry giants.

D2: SonyEricsson did eventually make their own Smartphone, but only after seeing the success of the Apple Smartphone and after losing a fair amount of market share and value. The first Xperia was only available one year later, and it took even more for the product to be considered on par with the Apple line of products technically – as it never would be on the same league going against a brand that was already much more established and popular. The product they came up with was technically good, but the decision could have been made earlier; in 2012, the market share of the Xperia was still below 4%, compared with a combined 64% for Apple and almost 8% for another newcomer Samsung.

D3: After 2007, SonyEricsson was too slow in reading the market, and they lost in just a couple of years the entire market share they had recovered since the beginning of the alliance. And to blame for that was a lost ability to keep up with a market that was more competitive, demanding, and changing faster than ever before: precisely the kind of condition that demand strong dynamic capabilities from the management.

D4: After the second shock, it was even clear (even more than in the first shock) that the resource base had to change again: Apple succeed due to its superior software capabilities combined with sense of design that helped put the iPhone in a completely different level from every other available product. The alliance of SonyEricsson faced a

problem, because it was clear that the major input brought by Ericsson was its technology know-how in mobile phones that were soon considered obsolete or at least out of fashion. Ericsson had not the financial power or even the mindset to decisively change its resource base again, and the only logical way out was for Sony to continue alone, as it would be more capable of doing the resource base change that was needed – Ericsson’s presence ceased to of great value.

Classifying each dimension:

	D1	D2	D3	D4
First Shock	Low	Medium/Low	Medium/High	High
Second Shock	Low	Medium/Low	Low	Low

There can be observed some differences in the levels enjoyed by the company in the four dimensions. This is due to resource configuration and other changes occurring between the two shocks. The biggest differences can be found in D3 and D4. In D3, the difference was down to the fact that the second shock was the one that really disrupted the market, making it much more difficult to make decisions according to it and the company lost track of the costumer shift for some time, as most older phone manufacturers. Additionally, the D4 further explains why the market related decisions could not be taken, as the resource base to actually do those decisions was really not enough and lacking, after the advent of a very different mobile phone industry, now dominated by Apple’s Smartphones.

In the end, the dynamic capabilities that would have been needed for the second shock were almost totally missing, and Ericsson had no chance to continue being an important player in the industry. In the first shock, however, it should be identified that the joint venture that expanded the resource base followed by several products aligned with the direction of the market allowed the company to survive its first big crisis and enjoyed a pretty good run from 2002 to 2007.

- 3) Characterize the main differences in the resource base required to succeed in the three main phases faced by Ericsson in the mobile phone industry during two decades (the stages: the 90s; the 2000s before the iPhone; after the iPhone)

In the 90s, phones were mainly communication tools, for which Ericsson had an expertise of more than a century and the resources needed one of the most dominant forces in the market, with market shares consistently over 10% in the 90s, and reaching a peak of almost 35%.

As the new millennium came, the phones were now being regarded as much more than just communication tools by consumers: the entertainment side was included through feature related to video, photo and music. Design was also very important; the phones had to “look good”. Ericsson was a bit lacking in these capabilities, and also at the same time it faced severe financial problems. The solution was the alliance with Sony, with its expertise in consumer electronics and design and ability to help Ericsson grow in new markets (like Asia).

Finally, after the iPhone, the phones were now a true experience for costumers (a huge vision of Steve Jobs’ vision for all the Apple products): a very advanced combination of software, hardware, features and touch capabilities that demanded a company strong in all these areas and able to put them together in a great product – the reason why software and electronic giants like Apple and Samsung were able to come to a new market for them and be so successful. These resources were outside of the resource pool that could be offered by Ericsson, which had its expertise in the communication side of the product and was no match for Apple and also Samsung in design or software.

Smartphones went from a niche product to the dominator of the market, and such a shift demanded resources that Ericsson did not have. The market shares for its phones were around just 4% in 2012, just before Sony bought Ericsson’ stake in the joint venture.

## Teaching Plan

The teaching plan assumes the class will have 90 minutes. If that is true, this would be my suggested distribution of time for the analysis of this dissertation (assuming there was already a good level in Dynamic Capabilities by the students):

Review of Dynamic Capabilities concept: 15 minutes

Summarize the Ericsson Case: 20 minutes

Question 1: 15 minutes

Question 2: 15 minutes

Question 3: 10 minutes

Conclusion, doubts and final thoughts: 15 minutes

## Discussion

The following section's main purpose is to relate the mentioned literature on the DCs view with the Ericsson teaching case. As it was already mentioned, the basic theoretical ground is the Barreto's (2010) definition of the DC concept: "A dynamic capability is the firm's potential to systematically solve problems, formed by its propensity to sense opportunities and threats, to make timely and market-oriented decisions, and to change its resource base".

This definition is composed of four dimensions (mentioned respectively from D1 to D4) that allow for different levels of dynamic capabilities (i.e: from very high to very low including all levels in between) instead of just assuming that companies have the DCs or not); another important feature of the definition to take into account is that the correlation between the four dimensions does not have to be necessarily strong, as it can be seen when analyzing the Ericsson case that presents different levels in the four variables and changes in those levels across the years.

The first dimension concerns the sensing of opportunities and threats, drawing from articles like Teece 2007 and entrepreneurial papers used for that article. It is stated in this research that the discovery and development of market opportunities is crucial for success; it is clear this was the case when Apple introduced the iPhone that completely changed the rules of the market. Ericsson had a good record after the first shock as it understood that the opportunity to built phones with increasing features would force the company to expand its resource base in order to stay on top; doing that with SonyEricsson, they would enjoy years of successful models in face of increasing competition – see exhibit 2. In the case of the Smartphone, this was a factor in which Ericsson failed, as it failed to assess the changes on costumer trends, and to identify the major threat posed by Smartphones that directly clashed with the "feature" strategy for the previous phones.

In the second dimension the issue is the propensity to make timely decisions, as a way for having advantages of being a first mover - connected with papers like Eisenhart and Martin (2000). In the case of Ericsson, it showed a consistently low level in this dimension: after the dotcom bubble and the huge loss of market value, the company took almost two years to finally setup the joint venture with Sony (from the beginning of 2000 when its value went down dramatically to the beginning of the JV in October 2001) that would give the company some recovery over the next years – with the late timing responsible for a big market share loss that could have been mitigated if it acted in a swifter way. In reacting to the iPhone, the timing was not the best again; with the first SonyEricsson Smartphone, Xperia, only coming a

full year after the iPhone introduction - too late in a very dynamic market where Apple had already established a very powerful brand with the iPhone (and with competitors like Blackberry with a strong market share in those products – see exhibits 6 and 7). Given the huge importance of timing in strategic decision, it is clear that the many poorly timed decision by Ericsson cost it a great deal in the performance in this rapidly changing sector.

The third dimension is the propensity to make market-oriented decisions – to be able to take decision that deliver a greater value to customers than the competitors. This third dimension was not the biggest problem for Ericsson; in both shocks (telecoms crash and introduction of iPhone) Ericsson was eventually able to do what was necessary to address the specific market condition for the next years. Respectively, Ericsson enlarge their resource base though the JV with Sony to be able to deliver greater features and better designs in their phones and coming up with a sophisticated Smartphone model to rival Apple). Eventually, the main factor that led to leaving the industry altogether was that the reaction to Apple (even though the SonyEricsson Smartphone product that followed was composed of technically good products), was a typical case of “too little, too late”. Its introduction in the market was not only too delayed but also Xperia did not bring anything truly original when compared to the competitors to truly challenge the established Smartphone players.

Last but not least, the fourth dimension addresses the propensity to change the resource base, a fundamental value to be able to truly display the DCs in the market – as mentioned in Eisenhardt and Martin (2000) and Teece (2007). Ericsson had a different record with this dimension with the two biggest shocks it faced: in the first, the JV with Sony clearly brought to the company some needed resources to recover the lost market share and truly establish itself as a global player in the new millennium (resources like the design or expertise in consumer electronics that was now needed for the more sophisticated phones that needed to be produced); however, following the iPhone, SonyEricsson clearly lacked not only the marketing capabilities of Apple, but also its software expertise and ability to combine it with hardware, design and customer focus to deliver revolutionary solutions like the touch capability. Worse, Ericsson was no longer bringing enough resources to “justify” its place in the joint venture, along with having a worse overall financial condition than Sony.

One crucial aspect of the DCs that justified its preeminence in the strategic debate following the article Teece et al (1997) was its applicability to rapidly changing environments, something previous theories like the RBV lacked. This issue is still a source of debate among several authors that followed. Zollo and Winter (2002) mention that companies would be more aware

of reconfiguring resource in the presence of rapidly changing markets, and Zaphra, Sapienza and Davidsson (2006) claimed the relation between the DCs and the rapid changes of the market environment did not necessarily exist.

In Ericsson's case, the mobile phone market was always a classic example of a very dynamic industry, and as a perfect example to analyze the validity of such a theory in practice. It is clear that some crucial decision that affected the firm's performance were clearly linked with the conditions of the market. In making the alliance with Sony, most analysts mentioned the need for Ericsson to complement its resource base in order to face the tougher times by building something that could combine entertainment features to Ericsson's communication expertise—thus making Sony a very good partner. The result was not a return to the best years in the 90s, but certainly a very improved performance in a market that was more competitive than it had ever been. In having to eventually leave the JV and the industry, it was clear that the inability to respond to Apple and gain a better performance was due to a low level in several of the 4 dimensions proposed by Barreto (2010) for the DCs, namely the inability to sense opportunities and threats, to reconfigure resources and to some degree to make timely decisions (or at least timely enough).

With this case, the DCs are able to explain the ups and downs in Ericsson's performance in the mobile phone market much more than any other concept. Ericsson was placed in an industry that throughout the new millennium was grown exponentially and with many competitors doing much better (Nokia and Motorola until 2007, Blackberry in the mid 2000s, Apple and Samsung following 2007) – see exhibits 6 to 9. It is also clear in this case that the industry-effect would not be able to fully explain the events mentioned in the case. The same can be argued about the RBV; this theory also puts the firm effect as the most important, but once again its inability to fully explain performance in a rapidly changing environment is brought to light: from 2002 to 2007, SonyEricsson had resources and capabilities that made the company responsible for several of the more innovate and successful models at the time. After 2007, those capabilities were still in the company, but as consumer tastes shifted after the huge success of the Smartphones and especially the iPhone, these capabilities were clearly no longer aligned with the market evolution and the new demands of the competition, and the firm's performance and market share suffered a big loss in the following years.

In the end, I would consider that the teaching case chosen for this dissertation does a very good job in explaining the close relation between management strategic decisions and the firm's performance. Moreover the dimensions proposed by Barreto (2010) are very relevant in

understanding the firm's response and subsequent performance when faced with major shocks that affected its presence in the industry.

## Conclusion

This dissertation is about the Dynamic Capabilities (DCs) view, one of the most important in the strategy management debate of the past few years. This concept is about how firms can achieve and sustain competitive advantages. It emerged in the past 15 years as previous dominant theories attempting to explain the competitive advantages failed to address companies' performance in rapidly changing environments.

The recent DCs definition by Barreto (2010) functioned as the main theoretical base for this dissertation being the main aim of this dissertation to apply the DCs concept to a real business world teaching case in a rapidly changing environment such as the mobile phone industry. The company chosen was Ericsson. After more than 130 years of history with its presence in the phone markets being one of its core businesses, the Swedish electronics giant choose to leave in 2011 the joint venture it had formed with Sony ten years before as a way to focus on its other businesses that were performing much better. With the end of the joint venture, so did end, more significantly, the presence of Ericsson in mobile phone market. Ericsson had one of the more innovative and commercially successful forces since the very beginning of the mobile phone emergence 20 years before, with some truly classic models having been made by the company.

This dissertation aimed at evaluating some of the strategic decision made by the company's management and to prove the importance of the DCs and especially of the four DCs dimensions proposed by Barreto (2010) to the evolution of the company's performance in this industry. By doing so, it brought to light the crucial importance of the relations between the strategic decisions of a company in relation to its environment, and regarding the timing and content of those decisions – in the end of the case, I hope it was soon clear that the level shown in the DCs proposed dimensions by Ericsson throughout several years was fundamental in shaping the eventual outcome of the company in the market. In the end, the much better evolution of the new industry competitors in the Smartphone age proved too strong and that eventually would took the company to leave the industry altogether.

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