The wave of mergers and acquisitions that has taken place over the past two years among telecommunications operators is being followed by a second round of moves by telephone manufacturers.

In April, the American company Lucent announced its merger with the French firm Alcatel; now Nokia and Siemens are the latest, having decided to join their telecommunications divisions. Nokia Siemens Networks, as the newly formed company has been named, will be the world’s second leading provider of fixed telephone infrastructure and third for mobile networks. Nokia tops the list of manufacturers of mobile phones while Siemens’ land-line telephone equipment is present in one third of the overall traffic of calls made throughout the world. Additionally, in the past few years the German company has made a number of moves to get into the markets for mobile telephones and Internet access. Thanks to this, the merger will give Nokia penetration in a market that is growing as fast as that of broadband Internet access, as well as allowing it to sell devices that combine fixed and mobile capabilities, which users are increasingly demanding.

The merger allows the companies to combine their two areas of knowledge, whereby creating the conditions necessary for achieving a sum of knowledge and capabilities far greater than they have had up to now. Along these lines, the department of research and development (R&D) in the new company may be the great beneficiary of the operation. This comes as a surprise since in its press statements, management at Nokia Siemens Networks have placed an emphasis on the savings that are expected to be generated from the economy of scale, or in other words, the possibility of obtaining more R&D products without an increase in fixed costs.

The new company expects to save some €1.5 billion annually until 2010, basically by reducing its investment in R&D and cutting its current workforce (60,000 employees) by 10% to 15% during its first two years of operation. With this move the company is looking to better position itself in order to compete with Huawei and ZTE. Thanks to their low costs, the two Asian rivals are gaining ground in markets traditionally dominated by American and European companies in emerging markets.
The problem, however, is that mergers do not necessarily generate economies of scale. When it comes to analyzing the impact that mergers and acquisitions have on innovation, two factors must be kept in mind: one is the market, with the other being the technology dominated by each of the merger’s participants. Generally, there are two kinds of mergers: the first is between rival companies, who possess similar technologies and compete in the same geographic markets; and the second, between companies who are not rivals but instead offer complementary technologies.

In the first model, it is indeed normal to generate economies of scale. In the second, which is where the merger between Nokia and Siemens we are currently looking at would be categorized, there is generally a plan for the reutilization of resources, new technological competition is created, and a critical mass is reached in new technology fields. However, the success of these new complementary areas requires a considerable amount of work and an increase in R&D spending.

Therefore, the new Nokia Siemens Networks should not focus on achieving economies of scale. Instead it should prioritize the development of leading-edge technology products that are able to meet a constantly more rigorous demand. The new company will have a hard time competing for prices with its Asian rivals and the major competitive advantage that it should seek to capitalize on is that which will come from the complementarities generated by their innovation departments. In other words, now is the time to invest, not to save.