RESEARCH MONEY

Volume 29 Number 9
May 28, 2015

Nortel was more to the nation than its dollar value - A post-mortem

By Peter MacKinnon, Peter Chapman and Jonathan Calof

"Don't it always seem to go, that you don't know what you've got till it's gone?"
— Joni Mitchell

No truer words apply as they do to Nortel. It takes decades of skill and investment to build a global corporation with world leading R&D capacity and first class products and services. Nortel was such a company. Was it worth saving? It depends on your point of view. This iconic company was one of only a few large Canadian transnational companies and one that operated and excelled in advancing telecommunications for Canada and the world. It was one of the most valued global companies in 2000 and was gone by 2009. Why?

Nortel's demise arose from a series of factors. Key among them was a near collapse in the business environment triggered by the level of 'irrational exuberance' of the times and the fact that key customers were losing faith in Nortel's ability to survive as a consequence of the telecom crash of 2001, as well as concern over Nortel's strategy. Fundamentally, it was the accumulation of internal decisions that set Nortel into a slow death spiral. It was a failure 20 years in the making. And it is far too simple to blame the failure on any particular individual or management decision.

When such a company is in trouble, allowing the unencumbered sale of its assets to foreign purchasers is something that a government should assess with due consideration to its national value. In Canada we have legislation in the form of the Investment Canada Act that requires government assessment of the value of a company to the nation, prior to any sale. Such legislation exists to prevent the wholesale disposal of national assets.

Nortel went to the federal government a number of times seeking assistance and assurance and was turned down each time. For example, in 2008-09, the company asked for a deferral in repayment of a $150-million federal export financing loan. The company was flatly told 'No, pay up when due.' From our interviews with both customers and senior Nortel executives, the $150 million likely would not have changed the outcome. Nortel went to the government too late for this kind of help to significantly alter the situation. But being turned down by the government was not a good signal to Nortel as its market and financial situation continued to deteriorate.

Without any apparent support, Nortel's board, based on 'expert advice', voted to file for bankruptcy protection. This would give Nortel time to reorganize, settle debts and sell some of its business units. A more focused, scaled-down Nortel was what customers wanted and it seemed a good solution to the then-current problems. Unfortunately, the prices being offered for these units were too low to fund Nortel's other units. A complex set of bankruptcy laws in Canada, US and the UK took a lot of the control away that Nortel needed to emerge from bankruptcy protection.

PATENTS SOLD FOR BILLIONS

The decision was now to sell all business units and effectively shut down Nortel as we knew it. Consequently a complex joint Canada-US auction was put in place and resulted in nearly all of Nortel's assets going to foreign companies, including Nortel's billions of dollars' worth of patents. Moreover, every foreign sale was either priced under the threshold rules of the Investment Canada Act or if valued above the threshold they were quickly approved as having a net benefit to Canada (e.g., jobs stay in Canada). This failed to realize that Canada was losing its global position as a respected telecommunications innovator.

Nortel executives and the board entered bankruptcy protection believing that the company was worth saving. So did at least two independent groups trying to acquire the company before its assets were sold off piecemeal to foreign interests.

From the perspective of those firms that acquired Nortel's assets, they definitely benefited from the company not being saved, as each successful bid winner could add Nortel bits to its own operations and hopefully enhance capabilities, revenues and profits.

In fact, they did just that. Based on our University of Ottawa research findings into the demise of Nortel, we learned that acquiring firms recovered their investment costs for Nortel assets in less than two years from the purchase (R$, March 31/14and April 16/15).

Those acquired assets remain market leaders and continue to generate billions of dollars for the new owners. In addition, many people interviewed for the Nortel study pointed out how much they thought Canada had lost and how much the foreign acquirers had gained. A fuller accounting of Canada's losses and foreign gains from the loss of Nortel would be an interesting and important future study.

Another significant impact of Nortel's demise hit Canada's research intensive universities and engineering and business schools. Prior to the crash, the company was the largest recruiter of top technical and business talent at universities throughout Canada. In addition, Nortel funded a wide range of university research as part of its status as the largest corporate R&D performer in the country.

GRADUATE STUDENTS LEFT THE COUNTRY

This all came to a halt with its demise and a significant amount of research funding disappeared. Top flight graduate students found it difficult to find jobs in Canada, so they began (and continue to) leave the country after earning their degrees, resulting in a significant net loss to Canada's economy. There seems to be a serious gap emerging between highly educated labour force expertise and lack of domestic jobs for that talent.

Given the scale of Nortel's R&D in Canada, the company emerged at the nexus of an entire ecosystem that supported not only Nortel but acted as a national innovation hub with related services and support organizations for a wide range of other companies from legal services through to venture capital firms and start-ups. With the demise of Nortel, this ecosystem broke up and some parts of it such as venture capital, fled the country. And without the Nortel-inspired ecosystem, it has become harder for firms seeking top flight engineering talent from abroad to attract it to Canada.

Nortel was a large complex public company operating throughout the world. To create that scale of operations required years of effort and billions of dollars in investment. All that vanished the day the company went on the chopping block. No start-up or for that matter any other Canadian company could possibly have stepped in to replace that global infrastructure. Companies fundamentally need to grow their own. Given that most of the assets went to foreign companies, Nortel's global operations were simply closed down as the acquiring firms already had their own infrastructure.

The broader implications of the loss of Nortel are still rippling through the economy. The loss to universities and the innovation ecosystem have yet to be rebuilt. For example, the R&D intensity in Ottawa — a former world class telecommunications and information technology cluster — has dropped dramatically, as has availability of venture capital and related services, meaning those jobs and value creation have also disappeared. So too have talented students who earn advanced degrees in Canadian universities and then move abroad for employment due to lack of opportunities in Canada.

Nortel made mistakes along its journey through the 1990s and 2000s as documented in the U of O reports. Yet it could have emerged from bankruptcy protection a meaner and leaner company — it needed government as a safety net and times were tough as the emergent financial crisis swept the world. Government failed to grasp the foundational and central role Nortel played in Canada's innovation system — a system government supports with words but not measurably meaningful actions.

The disappearance of Nortel, the very firm that created digital and optical communications and pioneered next-generation wireless, was a loss to both Canada and the world. Assembling a global team as talented, dedicated and visionary as Nortel is a rare event in the annals of business. Lessons learned from this failure are still playing out and will for years to come.

With a federal election on the horizon, we ask ourselves is there anything that the government could have done to save Nortel? Could the ongoing problems at Blackberry have been averted through government action? The quick answer given the approach normally taken by governments is no. It seems that when companies like Nortel are in serious trouble, they turn to the government for help.

As we learned from the study, there is a point where government money really will not make that much of a difference. The loss of Nortel and the troubles at Blackberry are signs of a weakening telecommunications industry in Canada. It should be a wake-up call to policy makers and business leaders. Telecommunications has been a strategic asset for Canada since its founding and an essential pillar of our socio-economic fabric to this day.

Let's look at the Nortel and Blackberry situation a different way. Should governments wait for an industry to signal they are in trouble? The answer from our study would be no. By the time industry signals to government that it is in difficulty, it may be too late. We suggest adopting a proactive approach: for industries that are deemed as strategically important to Canada, develop a joint industry-government foresight and business intelligence initiative at the federal level to provide early warning to both opportunities and threats?

Nortel lives on in the hearts and minds of today's global telecommunications industry. The company stumbled, the economy soured and Nortel was left to fall apart and die with little apparent thought to its national value and loss to Canada and the world.

The authors were key participants in a multi-year University of Ottawa study on the demise of Nortel. It can be found at: http://sites.telfer.uottawa.ca/nortelstudy.