Microsoft Continues Its Long History of Destroying Shareholder Value

Microsoft ($MSFT) has announced they will pay $22,678,857, for LinkedIn ($LNKD). I predict this will be yet another strategic blunder by the tech giant. The stockholders are seeing their wealth dumped down yet another rathole. LinkedIn stockholders, welcome to the company that bought Skype, Nokia's handset business, and several other losers.

Disclaimer: I consulted for Microsoft's mobile division quite a few years ago. I'm still under NDA. But I am allowed to say that our team consistently recommended ABN – Anything But Nokia. We thought Nokia's technology was at least five years behind competitors in the smartphone segment. And Blackberry has always been available. While you may not like Blackberry handsets, they were a world better than Nokia's 12 key handsets.

LinkedIn's stock price was up a nifty % today. Those who managed to buy 100 shares Friday saw their LinkedIn wealth increase from $11,291 to $19,221. Not bad for a one-weekend holding period. I won't bother to calculate the annual rate of return. Excel™ would probably experience an overflow if I did.

But if you bought those 100 shares a year ago you would have paid $21,575. Long-term investors are probably not feeling very good about this. I have already read some grumbling from people who apparently think the Microsoft offer is too low. My guesstimate: those folks are confusing cost basis with sunk cost. If anything the Microsoft offer is too high.

The question is what Microsoft bought. LinkedIn's value is directly related to its membership. The company claims 413,671,000 members worldwide. Figure 1 shows the numbers. While that 19% growth rate sounds pretty good, the comparable figure for 2013-2014 was 25%.

Figure 1: LinkedIn Membership (source: annual report) (Click image to enlarge)

The Active Members

But what about active members? This is from the LinkedIn annual report for 2015 [Emphasis in the body text added by me]:

> **The number of our registered members is higher than the number of actual members and a substantial majority of our traffic is generated by a minority of our members. Our business may be adversely impacted if we are unable to attract and retain additional members who actively use our services.**
>
> The number of registered members in our network is higher than the number of actual members because some members have multiple registrations, other members have died or become incapacitated, and others may have registered under fictitious names or created fraudulent accounts. While the number of registered members represents what we believe to be reasonable estimates of our member base, there are inherent challenges in ensuring that the number of registered members presents an accurate reflection of our member network. For example, we do not have a reliable system for identifying and counting duplicate or fraudulent accounts, or deceased, incapacitated or other non-members and so we

> rely on estimates and assumptions, which may not be accurate. In addition, our methodology for measuring our membership numbers, and specifically for making estimates regarding non-members who should not be included as registered members, has changed over time and may continue to change from time to time. While we are using what we believe to be reasonable and appropriate methods of measuring the number of registered members, there are no methodologies available that would provide us with an exact number of non-actual member types of accounts. Therefore, we cannot assure you that our current or future methodologies are accurate, and we will need to continue to adjust them in the future from time to time, which could result in the number of registered members being lower or higher than expected. **Further, a substantial majority of our members do not visit our websites on a monthly basis, and a substantial majority of our desktop and mobile traffic is generated by a minority of our members.** If the number of our actual members does not meet our expectations, if the rate at which we add new members slows or declines or if we are unable to increase the breadth and frequency of our visiting members, then our business may not grow as fast as we expect.

"… a substantial majority …" is kind of vague. Let's assume 60% is "substantial." Figure 2 shows what Microsoft actually paid. (Don't like 60%? Click here to download my Excel workbook. Bonus: the workbook includes LinkedIn annual and quarterly financials for 2015.)

Figuser 2: My Estimate of Active Users (click for larger image)

So what's the cost per member? Depends on which number you believe. Figure 3 shows two estimates.

Figure 3: Cost Per Member

Estimate (4) uses the total number of registered members from Figure 2. And $50 per user doesn’t sound all that expensive. Ah, but what about *active* members? That’s estimate (3). And $137 per user is quite a bit more expensive.

Another Opinion

Over at Chris O’Brien has a similar take in his article “5 reasons Microsoft’s $26B LinkedIn deal will be a catastrophic failure.” Here are some excerpts:

> **LinkedIn’s value:** There are lots of upbeat stats in the releases today about LinkedIn’s growth. But on February 2, the company’s stock was trading at $203 per share. Then LinkedIn provided an outlook for the full year that fell well short of Wall Street’s expectations. Investors shaved an epic 40 percent of the stock price in one day.
>
> **LinkedIn’s business:** Beyond the question of fair value, there is the company’s underlying business to consider. The reason investors freaked out was because ad growth was slowing, and so was U.S. job growth. That’s a tough combo for LinkedIn, and it doesn’t exactly signal a wealth of momentum going into an acquisition.
>
> **Microsoft’s track record:** Let’s put aside the fact that this is almost four times as much as the company paid for its dismal Nokia deal. Microsoft bought Yammer in 2012 for $1.2 billion and Skype before that for $8.5 billion. How many enterprise-type communication platforms does one company need?
>
> **Acquisition double-talk, part 1:** On the one hand, this deal is all about the oft-vaunted idea of “synergy” (even if that word is not used). The idea is presumably to build LinkedIn into all sorts of Microsoft products. Great! But, does this mean I’m going to get all sorts of messages suddenly asking if I want

to share my Word doc through LinkedIn or have some LinkedIn integration with an Excel spreadsheet…or…what?

Acquisition double talk, part 2: Structurally, LinkedIn is going to remain independent. Per the Nadella memo:

"LinkedIn will retain its distinct brand and independence, as well as their culture which is very much aligned with ours. Jeff (Weiner) will continue to be CEO of LinkedIn, he'll report to me and join our senior leadership team. In essence, what I've asked Jeff to do is manage LinkedIn with key performance metrics that accrue to our overall success. He'll decide from there what makes sense to integrate and what does not."

So, we will all work together. But we will work together while remaining separate. We call it: Separate Togetherness. (I'm going to copyright that and write a book on it one day.)

In any case, one can already imagine the turf wars!

Actually, it doesn't take much imagination.

Strategy, Tactics, and Growth

Does Microsoft even have a strategy? Or did LinkedIn just look like a bargain? Here's a tip: there are no bargains in which the technology you are using does not meet users' needs. Upwards of 60 percent of LinkedIn members visit the site once a month or less. About the only way Microsoft can reach those members is via e-mail. Leading to the following comment from Twitter user @MattVATech:

Matt’s comment (click for larger image)

Conclusion

I once owned a bit of Microsoft stock. I sold it quite a few years ago. The price has barely moved since then. I don’t claim any special forecasting skills, but sometimes a company misses an obvious solution. For Microsoft, I recommend the same strategic advice Carl Icahn once gave to the Blockbuster board. Mr. Icahn realized that Blockbuster was in a dying market segment, soon to be displaced by streaming video. What the company did have was a large cash flow. Mr. Icahn wanted Blockbuster to begin a program of paying large dividends to stockholders. The board decided against this. And another large chunk of stockholder wealth went up in smoke.

Microsoft would do well to consider a similar strategy. If Office isn’t a cash cow, then I’ve never seen one. And shut down mobile, online, and all the other divisions not paying their way. That means matching the Windows and Office segment returns on investment.