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Palm (C): 2005

Palm Splits into Two

In December 2001, Palm split its Platform business into a wholly owned subsidiary to focus solely on its OS. The name PalmSource was given to the subsidiary later in 2002. PalmSource received its first outside investment when Sony injected \$20 million into the company. The corporate structure changed once again when Palm completed the spin-off of PalmSource as a separate company in October 2003. Palm felt that the PalmSource spin-off would provide “clarity of focus and mission for both businesses” and “create a level playing field among current and future licensees.”¹

Since operating as a separate company from 2001 to 2003, Palm OS-powered products had maintained the leading market position by managing a number of licenses including Palm (the hardware company), Handspring, Sony, Garmin, Group Sense PDA, Kyocera, and Samsung.² Despite the early success of PalmSource as a stand-alone company, on the hardware side, both Palm and Handspring were facing economic hardships as the market for handheld devices slowed.

At the same time of PalmSource’s IPO in October 2003, Palm (the hardware company) announced that it would be acquiring Handspring, giving Palm access to Handspring’s Treo smartphone, which was seen to be a crucial development for the years ahead. To signal the changes, Palm changed its name to palmOne. palmOne later bought back the rights and changed its name back to Palm in May 2005. Also in May 2005, Ed Colligan, formerly the VP of Marketing at Palm (since 1993) and then the COO and president of Handspring, was named CEO and president of Palm.³

Platform Developments at PalmSource

As time wore on, many in the industry doubted that PalmSource could be successful as a stand-alone company. Industry observers commented on PalmSource’s weakening negotiating power, the general lack of interest with hardware manufacturers to license Palm OS and the loss of market share to Microsoft. By the end of 2004, handheld devices running Windows Mobile OS overtook Palm OS-powered devices for the first time.⁴ In smartphones, Symbian (the product of Psion’s original EPOC OS) was the dominant OS. (see **Exhibit 1**).

After becoming a separate company, PalmSource announced a new operating system, Cobalt 6.0. In coordination with the announcement, it provided plans for the next version, Cobalt 6.1, which had several superior characteristics above 6.0 such as phone capabilities, VGA (Video Graphics Array),

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and Bluetooth. As one developer stated, "Showing the road map was an error, because the licensees wanted to wait for 6.1. [Cobalt 6.0] only had the user interface, so it was too expensive for the licensees to develop."⁵

Resource constraints set in as the company split its time between providing support to hardware developers and developing the next Palm OS. To improve its position, PalmSource looked to broaden its possibilities by purchasing China MobileSoft in 2004 to develop mobile phone software with open-source software Linux. Again, several industry observers believed that PalmSource made a misstep with the timing of the announcement since the acquisition was immediately after the release of Cobalt 6.1, which dampened demand for 6.1 as developers waited for the new Linux version. It later announced in mid-2005 that it would be joining forces with MontaVista Software (a prominent Linux developer in telecommunications) to develop the next generation of phones running on Linux.

Many in the industry wondered whether the migration to Linux spelled the death for the Palm OS? Was there anything that could be done?

Exhibit 1 Market Share**Worldwide Smart Mobile Device Market Share by Operating System**

	Q2 2005	% Share	Q2 2004	% Share
Symbian	7,648,920	62.8%	2,429,930	41.0%
Microsoft	1,931,630	15.9%	1,360,220	22.9%
PalmSource	1,157,720	9.5%	1,335,810	22.5%
Others	1,447,330	11.9%	807,370	13.6%
Total	12,185,600	100.0%	5,933,330	100.0%

Worldwide PDA Shipments Estimates by Operating System

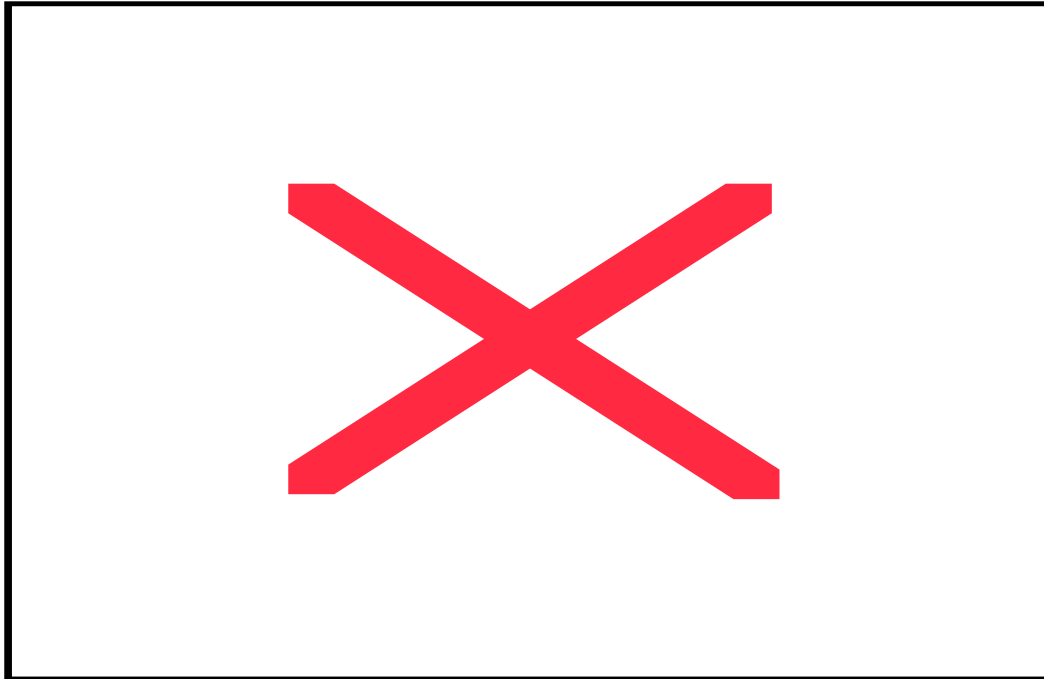
	Q2 2005	% Share	Q2 2004	% Share
Windows CE	1,653,638	45.7%	1,006,923	36.6%
Research in Motion	840,000	23.2%	510,000	18.6%
Palm OS	678,750	18.8%	1,147,667	41.8%
Symbian	275,000	7.6%		0.0%
Linux	28,000	0.8%	27,500	1.0%
Others	140,400	3.9%	56,710	2.1%
Total	3,615,788	100.0%	2,748,800	100.0%

Source: Adapted from Canalys and Gartner Dataquest reports in the HBS case:

David B. Yoffie and Barbara J. Mack, "PalmSource 2005,"

Harvard Business Case, 9-706-420, August 10, 2006, p. 6.

Exhibit 2 Performance of Palm



Financial Statements of Palm and PalmSource

USD\$ thousands	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Year ending in May										
								Palm Acquires Handspring and Spins-off PalmSource		
PALM										
Revenue	7,054	114,157	272,137	563,525	1,057,597	1,559,597	1,030,831	837,637	949,654	1,270,410
Cost of Revenues	4,479	77,685	157,749	315,945	613,628	1,333,943	649,987	625,879	677,365	880,358
Gross Margin	2,575	36,472	114,388	247,580	443,969	225,654	380,844	211,758	272,289	390,052
Gross Margin %	36.5%	31.9%	42.0%	43.9%	42.0%	14.5%	36.9%	25.3%	28.7%	30.7%
Operating Income	-6,777	-13,513	6,461	48,339	61,449	-566,072	-108,843	-197,932	-4,080	77,528
Net Income	-3,062	-7,862	4,171	29,628	45,910	-356,476	-82,168	-442,582	-21,849	66,387
						Subsidiary Created		PalmSource is Spun-Off		
PALM SOURCE										
Revenue						26,252	44,950	73,414	73,117	71,911
Cost of Revenues						5,449	10,603	10,221	6,174	4,919
Gross Margin						20,803	34,347	63,193	66,943	66,992
Gross Margin %						79.2%	76.4%	86.1%	91.6%	93.2%
Operating Income						-84,020	-50,149	-14,206	-12,799	-10,241
Net Income						-84,018	-51,247	-21,760	-15,247	19,482

Source: Taken from Annual Reports, 10-K. For Palm, 1996 to 1998 taken from Annual Report 2000; 1999 to 2002 taken from Annual Report 2003; 2003 to 2005 taken from Annual Report 2007. For PalmSource, all figures were taken from Annual Report 2005.

Note: All Palm figures prior to 2003 include both hardware and software. After 2003, Palm is hardware only.
In 2001 and 2002, Palm financials are consolidated and include the PalmSource subsidiary.

Endnotes

¹ "Palm Announces Acquisition of Handspring to Bolster Industry Leadership; Board Approves PalmSource Spin-off," Press Release, June 4, 2003, <http://www.palm.com/us/company/pr/2003/060403.html>, Accessed October 23, 2007.

² PalmSource Annual Report 2004, May 28, 2004, p. 1, <http://www.sec.gov/Archives/edgar/data/1178056/000119312504144437/d10k.htm>

³ "palmOne Board Names Ed Colligan CEO," May 16, 2005, <http://www.palm.com/us/company/pr/2005/051605b.html>, Accessed April 16, 2008.

⁴ Richard Shim and Dawn Kawamoto, "Is Linux Palm's savior?" CNET News.com, May 25, 2005, http://www.news.com/Is-Linux-Palms-savior/2100-1047_3-5719142.html?tag=st.num, Accessed October 24, 2007.

⁵ Ibid.