

Interview

On quality and quantity

The poor reception quality of Megafon is an impression that went out of date a long time ago

Sergey Kolesov

Megafon has come on the federal cellular communications market a little bit more than three years ago, and currently keeps a secure position among its three leaders. Megafon has been able to maintain its image of innovative and technologically advanced company, in spite of the severest competition. Sergey Soldatenkov, the CEO of Megafon, answers the questions of the "Ko" site visitors (www.ko.ru).

As everybody knows, an event is non-existent as long as it's not spoken about on TV. A brand is non-existent as long as people do not have the idea of it in their own heads. Being the youngest cellular operator of the "big three", Megafon put a stake on the aggressive marketing from the very beginning of its appearance on the market in May, 2002. And the time has shown that the choice was right. It was the first in Russia to create a full-fledged cellular communication brand, appealing not so much to the consumers' minds, as to the consumers' emotions. But everything has its own price: for a long time Megafon suffered from the poor communication quality. Sergey Soldatenkov, who assumed the CEO's office of the company in 2003, encountered this problem, along with the others.

The other most difficult challenge had to do with the squabbles that started in 2003 between the operator's stockholders, after the purchase of its blocking shareholding by the Alfa-Group. The new CEO had to steer the company between Scylla of market demands and Charybdis of controversial stockholders' interests. And Soldatenkov has succeeded in that. Though one of the main tasks which Megafon has to fulfill yet - going on IPO - still stays at the uncertain stage.

"Ko": This question is not unique at all, but it is still very pressing: How do you estimate the Beeline's rebranding? It seems that on a consumption level their target group is now overlapping with yours - young people and innovators?

- Here we may single out two different issues: a corporate style's change and a change of positioning. About the first, I can say for sure that their new stylistic solution is much better than the old one. Moreover, when they gave up their traditional "bee" symbol, they have received quite wide informational resonance about the company...

But concerning the positioning, the matter is somehow different. This transformation

is much more significant, than just the change of a logotype. Only time can show now if it really was advisable. Beeline reorients itself to the young people, who are one of the basic target groups of Megafon. Taking into account that this market is quite stable by now, Beeline runs the risk of failure in getting their wanted results from this rebranding.

Artem Kazakov: What is the main competitive advantage of your company? Will Megafon be able to become Russia's cellular operator No. 1 in any foreseeable future?

- Flexible and transparent tariff policy of Megafon allows to take into consideration the needs of all subscriber groups and to give prompt response to their variation. Diversity of services is one of main competitive advantages of Megafon. Moreover, the company is a recognized leader in the field of introduction of newest technologies. In this year we expect to raise the share of additional services in the whole revenue up to 20%. To compare: This figure was at the level of 6% in 2003, and of more than 11% in 2004. Furthermore, Megafon has an essential technological advantage over it's competitors - most of company's networks are built with the use of the most modern equipment, which we will not have to upgrade very soon.

One has to understand that the number of subscribers is not the only indicator of a company's success. Last year Megafon had 18% of the market and earned 20% of the market's revenues. Most analysts tend to state that these figures say more about the level of company's development, than the number of SIM cards sold.

Of course, Megafon strives to increase the subscribers' base, and we are satisfied the rate of it's growth: it has doubled in the last year. At the end of August, 2005, the number of our subscribers was more than 20 million, while in August, 2004, we serviced only 10 million subscribers. But we are primarily interested in the quality of the subscriber's base, and it's quantity is only secondary.

"Ko": Who is responsible for the promotional actions for Megafon? Do you plan to change the advertising appeal?

- Megafon cooperates with the creative agency "McCann Erickson" for two years by now. Advertising appeal is based on the business strategy of the company, which is not yet to be revised. Our target group is middle class - young and energetic people. Our slogan, "The future depends on you" is primarily a statement of their life attitude. As an operator, we have values which are identical to the life values of our subscribers. The main subject which is promoted through marketing communications is "constant development". Development of relationships between people,

development of a personality in time, creativity, which may come true due to this development. The building of a strong trade mark is one of our main competitive advantages. And the fact that Beeline decided to follow our example, is just another acknowledgement of the right choice which Megafon has taken regarding the strategy.

"Ko": From it's very first steps on the market Megafon has been placing the special emphasis on marketing. But at the same time the technical performance characteristics were and still are not at the high level: the reception quality in Moscow as well as in some other regions is still leaves much to be desired. What is the cause and the effect? Megafon did not have a possibility to build a strong network, so it has been deliberately placing more emphasis on the marketing, or Megafon was so involved with marketing that has lost the view of technical issues?

- I'd like to remind you that Megafon works not in Moscow only. Our company entered the market for the first time in Saint-Petersburg in January, 1995. By moment of launch the network consisted of 13 base stations. By the end of that year, ZAO "North-West GSM" (which currently is the north-west branch of OJSC Megafon) was delivering services to 8000 subscribers, and had 23 base stations. In a year, we had already 63 of them.

The crucial distinguishing feature of our business approach is commitment to the principle of self-dependent building of our networks. This approach has a doubtless advantage - we are able to use the newest equipment and along with that we minimize the purchase expenditures due to the volumes of the orders. Taking into account the fact that the network development expenditures are paid in the long run by the consumers' money, one can see that our subscribers get two advantages at once: high-quality network and balanced price offer.

Moreover, numerous independent examinations have shown that the poor reception of Megafon in Moscow is an impression that went out of date a long time ago. "Megafon - Moscow" network has had a significant growth since 2001, and still keeps growing. For example, at the beginning of this year we had 1000 base stations in Moscow region. There are 1500 already.

Maksim Suchkov: It is not a secret that cellular operators in Europe are the main buyers of mobile phones. Afterwards they sell them at the comparatively low prices together with their contracts. Does Megafon have any plans to follow this direction and subsidize cell phones?

- European cellular communications market is very congested, so mobile communication operators have to express considerable ingenuity to involve and keep their subscribers. Russian market, notwithstanding its rapid development in the last years, is quite far away from saturation. Certainly, in such big cities as Moscow and Saint-Petersburg, mobile communications have penetrated almost every corner. But in provinces, the saturation which can seriously prevent the rates of the growth, will not take place very soon. So the practice of subsidizing of cell phones will not be relevant for Russia in the nearest future. However, we do not go for it for one more reason. Megafon offers its subscribers the power of choice, and those operators which somehow try to make their subscribers to be loyal, can not boast about something like this. We prefer to encourage our loyal subscribers by other means. For example, through "Megafon-Bonus" program.

"Ko": How far advanced is the level of marketing communications of domestic cellular operators, in comparison with the international operators like Vodafone, Orange or T-mobile? Did we learn to make marketing of the world-recognized quality?

- The level of marketing communications is defined to a big degree by the competition. In the area of cellular communications the competition in Russia is not as intense as in Western Europe. Nevertheless, today we have a possibility to observe some very interesting marketing initiatives of the cellular operators. Megafon has always been giving all possible care to the issue of marketing communications. The most part of the solutions which were new for the Russian market - for example, the first tariff with free incoming calls - was offered by us. A revolutionary tariff called "The reception" changed at that time the whole idea of mobile services consumption in Russia.

Oleg Vyacheslavovich: When do you plan to achieve high quality coverage of the Moscow region at least in 100 kilometers zone? Also, we are interested to hear about the reception in Moscow subway.

"Megafon-Moscow" was constructing dozens of new base stations through the whole summer. It has improved the communication quality in city's center, along the perimeter of the Third Transportation Ring, major highways and city's bedroom communities. New objects were included in the network's coverage in the Moscow subway - Tagansky interchange stations block. New base stations were constructed in Moscow region, in Balashikha, Voskresensk, Khimki, in districts of Dmitrov, Istra, Lyubertsy, Naro-Fominsk, Noginsk, Ramenskoye, Stoupino and Schelkovo. The whole number of base stations in Moscow region is now close to one and a half

thousand.

"Ko": What is your prognosis regarding the EDGE protocol in Russia?

- Right now Megafon has about 2500 cells which support EDGE protocol. They are located in places with the most intensity of the traffic. All newly delivered base stations support EDGE by default. The stations constructed earlier will be upgraded in the whole network coverage area. Expenditures on EGDE introduction amount to \$3000 - \$4000 for a cell. By our evaluations, the introduction of EDGE increases traffic by one fifth.

There exist certain future perspectives for high-speed data communication technologies in wireless networks. The Far East, for example, is the most active consumer of mobile Internet services. And the reason for that is very simple: the region has very poor developed hard-wire Internet providing, which makes mobile Internet the almost only possibility to get online. Besides, there are a lot of attractive GPRS/EDGE based features for subscribers: for example, MMS or mobile television. Other features will be developed as well. The future of these new features depends a lot on the young generation, which is the most active and grateful user of innovative products.

Yevgeniy Chereshnev: Today any Internet user can speak for free with any place in the world. How do you estimate the influence on GSM-operators of voice IP-messengers, like Skype, etc?

- There is no influence at all. This software has any impact on a very little fraction of our subscribers group. Even theoretically, there could be some sort of competition only in places equipped by Wi-Fi hot-spots. To start the competition with the Skype for true, we need our subscriber to carry along with him or her a mobile computer equipped by Wi-Fi and all needed software installed. Furthermore, he or she has to stay inside the coverage of some hot-spot, which does not belong to Megafon itself, otherwise we still get profit from the subscriber's call. Not every user at all is able to figure out on his own all technical parameters and options which need to be set in IP-messenger. Moreover, the cost of a usual call is so small, that it hardly can stimulate anyone to spend all those efforts on that.

Oleg Gavrilishin: You have an image of the most cutting edge company as it regards the introduction of non-standard services. Do you have any surprises for your subscribers in the nearest future?

- In the nearest time all cellular network subscribers (not only those of Megafon) will be able to make use of additional services through the MegafonPRO Web portal.

Aleksandr Safronov: When do you plan to complete the consolidation procedure of Megafon's subsidiaries? Will subscribers of the company feel in any form or shape the change of it's legal structure? Is there a risk to repeat to some degree a notorious proceedings between "Impuls" construction department and "Vympelkom" in Moscow region? Will this subsidiaries' joining pave the way to the creation of unified roaming-free territory for your subscribers?

- In future, we expect the reorganization of all subsidiaries of the OJSC Megafon, with the following re-registration of all licenses to the head company. But what is really important here is not only and not so much a legal consolidation, as business consolidation, expressed by the unification of company's business processes. Here we have done a considerable work with our subsidiaries. We have centralized the most part of the processes, though our regional organizations still keep the right to make their own tactical decisions on local markets.

We can not repeat the proceedings of our colleagues for one simple reason - all operators of Megafon network in provinces have all the relevant licenses and make their contracts with subscribers from their own name.

The legal procedure of joining of Megafon subsidiaries will have no visible consequences for our subscribers. But they have already seen and appreciated the results of the unification. Now they have a possibility to use the same payment means within our network, to receive the same set of services of the same quality, no matter where they stay. The other very important achievement is roaming-free territories in the macro-regions.

"Ko": Is the stockholders' conflict making any influence on Megafon's activities? How do you minimize it's side effects?

- I can say that the majority of Megafon's stockholders understand the tasks which the company has. We fulfill all our plans in time, and some of them are even being completed in advance. The stockholders' conflict for sure has certain influence on the activity of the operator, but we have successfully put into reality all our plans.

"Ko": How would you comment the recent news that the 100 million subscribers' level was reached in Russia? There is an opinion, that from the certain time 'number of subscribers' ceased to be the thing of the major priority for cellular operators - now they are much more interested in quality.

- The rate of development of Russian telecommunications in recent years is quite good. Particularly, the cellular communications market can be considered as one of the most perspective sectors of the national economy. Analysts were forecasting that the number of 100 million subscribers will be achieved at the end of 2005. But, as it usually happens, the reality has come earlier than anyone planned. It is significant that the polemics on the issue of how informative is the number of cellular operators' subscribers, that has taken place in the beginning of this year in media, actually has a solid foundation for itself. Still, different operators keep different principles for statistics. Statistical data on the increase of subscribers' base is important, but not the only indicators of business success. But every company has it's own different strategy, and so measures it's success in different terms. For example, Megafon has no purpose to strive for a leading position and get the maximum number of subscribers by any means. Our stockholders gave us another task - to keep the high economic efficiency.

"Ko": What are your development planes for the company for the nearest year? What investments you will need for them, and where are you going to find those investments: IPO, loans or something else?

- We consider the further coverage of licensed territory in Russia as our main development challenge for the nearest future. For the current year we have planned investments of \$1.2 billion. As finance sources Megafon will use all available options: bank credits, suppliers' credits, stockholders' stakes, rouble- and euro-bonds and our own funds. Of course, IPO is an attractive financial tool. But this is not an end in itself, but one of the investments' sources. The company prepares itself for entering the public market, but the decision about the advisability of such placement is to be taken by the stockholders.

"Ko": What do you think of the idea of allowing subscribers to change their cellular operator while keeping the same phone number? Why this was not introduced yet in our country?

- Upon the introduction of such a service, cellular operators will be able to compete

for subscribers only through the marketing initiatives, as they won't be able to use "restraining" methods. We think that this would help to recover the healthy competition on the market.

"Ko": What is the share of non-voice services in the structure of company's revenue? Do you consider that this is the indicator of the market becoming more civilized?

- We hope that in 2005 the share of the additional services will amount to 20% of the revenue. The innovation indicator is increasing every year. So, in 2003 the average share of additional services in the company amounted to 5,5%, and in 2004 - already to 11.5%. This means that the number and popularity of additional services have reached a level where they need separate promotion and segmentation by the target groups. Additional services are no longer considered as something additional to the voice communication service, and that now they have their own value. Certainly this is a sign of the market's maturity. CJSC TT mobile, working in Tajikistan, 75% of which belongs to OJSC Megafon, has announced on June 14, 2005, about the launch of the 3G UMTS standard network in the republic. The UMTS network in Tajikistan is the first step of Megafon to the third generation communication. We already have certain know-how which we have accumulated while testing 3G in Russian test zones, and we share it with TT mobile. When we in our turn will start constructing our third generation network in Russia, Megafon will get an essential competitive advantage, as the company will have the possibility to use the experience of the launch and servicing of the 3G network, tested on the already functioning network in Tajikistan.

"Ko": Can you tell us about how Megafon builds it's relationships with content-providers?

- Starting for the beginning of this year, we have unified the agreement relationships with content-providers and now we are applying the unified model contract. This document is available for download from our web site from the section called "To content providers". By the new conditions, our partner (content-provider) takes the full responsibility for the quality of the content delivered. The proportional division of revenue currently is on average 60/40 in favor of a provider.

"Ko": What structure of cellular communications market you consider the most likely and optimal for Russia?

- I think that the current structure is close to the optimum. There are three major mobile communications operators and several regional operators - so there is quite an intense competition on this market. I would not also exclude the likelihood of the appearance of the fourth federal level player here.

Boris Weinstein: From the business viewpoint, what are your considerations regarding the possible perspectives after the entrance of Megafon in Yakutia? One of your competitors has made certain steps in this direction.

- In many areas Megafon came later than the competitors. Still we were able to win favorable positions on those markets. The appearance of a new federal-level player in Yakutia has energized the market and increased the competition, and subscribers felt that at once. Megafon has come into the area with interesting tariff offers and unique additional services for the local market. The response of the Yakutians speaks for itself - in the very first month we got 18 000 subscribers. By the results of the end of August we keep 20% of Yakutian cellular communications market.

"Ko": What is Megafon's strategy for the expansion of the network: acquisition of regional cellular operators or deployment of it's own base stations? Why did you make that choice?

- All Megafon regional network operators were built from scratch. Acquisition of already existing networks is only applicable when company has no license for a certain area. This strategy has it's own advantages, but there are disadvantages, too. Acquisition of a company means also acquisition of it's subscribers' base, licenses, frequency resources etc. With that, one also gets negative things like financial obligations, consequences of network's non-optimal radio-planning, quite often it is also obsolete equipment.

As we have the licenses for all country's regions, we usually just enter the region, get the frequencies and construct our own network. With that, there are certain savings of time when one acquires small regional operators, so we do not exclude this way for our development.

Sergey Soldatenkov's CV

Born: 1963

Education: the Leningrad Institute of Aviation Instruments, a degree in radio engineering.

Professional experience:

2003 - until now: Chief Executive Officer of OJSC MegaFon

2002 - 2003: Vice-President of LLC "United Company "GROS".

2000 - 2002: Deputy CEO for Commercial Affairs, Acting Chief Executive Officer, CEO of OJSC "Petersburg Telephone Networks" (re-organized as OJSC "North-West Telecom").

1999 - 2000: Deputy CEO of CJSC Telecominvest

1994 - 1999: CEO of CJSC "Delta Telecom"

1993 - 1994: Chief Executive Officer of JSC "ARS", the Russian-British joint venture

1992 - 1993: Executive Director of JSC Impex-Group

Family status: married, has a son

Hobby: traveling

What is Megafon

OJSC Megafon is a third largest cellular operator in Russia. Revenue by US GAAP in 2004 amounted to \$1.48 billion, which is 81% more than in 2003. Average monthly revenue for user (ARPU) amounted to \$12,4 in 2004. The number of subscribers serviced was more than 20 million in 2005. The major stockholders of OJSC Megafon are OJSC Telecominvest, CT-Mobile Ltd, TeliaSonera group of companies (Finland, Sweden).