



World Report in Turkey

An interview with Paul Doany, Executive Chairman Turk Telekom (March 2007)

World Report: If the ICT-sector is a good indicator of the level of sophistication of a country, how sophisticated would you say Turkey is today?

Paul Doany: Turkey is well developed in the ICT sector, with modern network infrastructures in both fixed and mobile technologies, particularly in advanced digital communications and data networks.

Looking at this from a service provider's perspective, Turkey is a very large country, with different mixes of market segments. The Istanbul region generates the largest share of revenue; it has the largest number of banks, financial institutions, and most of the services sector businesses. Even in terms of technology, Istanbul has attracted businesses in areas benefiting from special arrangements, such as the Technopark and other similar projects.

Ankara also has some good successes in that regard. Ankara is lot quieter as a city, but it has its own special charm. There is a very high level of education there (which is generally the case throughout most of Turkey). Ankara has its good share of top universities, and of course is the main seat of government. Several companies operate out of Ankara, which also has a successful Technopark. As our operational HQ is in Ankara, our recruits are mostly in technical functions. We have begun to move the main management functions to Istanbul, including a new strategy department, in addition to sales/marketing/customer care, finance, HR and a mix of regulatory disciplines, although support functions in all these areas will be kept in Ankara.

So Ankara will be our 'operational base', while Istanbul will host our 'management base'.

We have 81 provincial directorates, with teams responsible for network performance and service delivery in their respective areas. We met over the past 5 days with 5000 people comprising our top management within the 81 regions. We also invited our main dealers that sell our products and services, as we have a total of around 3000 exclusive franchises, in

addition to our solution partners and resellers. It was an interesting experience for me to meet so many people from so many different parts of the country. We have only 1 female provincial director at the moment: She stood up during the formal meetings and said that the main customers (ie users of fixed phones) are women, and yet she had no female managers - Clearly we need to improve this!

Generally, we don't have enough female managers in the company, being a traditional network engineering company. Our initial target was for at least a third of our managers to be women, but we have not had much progress yet. In Turkey, if you look in universities, such as engineering, chemistry, biology, science or management classes, you will find around a third (or even in some cases half) are women. It's far higher than Western Europe. Women in Turkey have enjoyed equal rights for a long time - they had the right to vote before Switzerland. Turkey, in that regard, is a very advanced country.

The Turkish market may be viewed in terms of 3 to 4 main segments. At the very top per capita GDP is equivalent to European capital cities, say the largest few cities, down to the much poorer areas.

Turkey's ICT sector has registered an average growth of 12% in the last few years. How do you explain this impressive rate?

Overall ICT growth has been observed in many places, and in Turkey one of the major factors that contributes to this growth is the low level of PC-penetration, which year by year has seen high increases. At the end of 2005 there were 5 million PCs, which is very low, but at the end of 2006, there were close to 6.5 million. The national target is 10 million PCs in Turkey, in 18 months. Everyone is working hard to achieve this, noting that such low penetration is not due to limited affordability.

There are many Turkish domestic vendors, with strong brands, so that should help. People in Turkey are very outgoing and spend a lot of time out of the house. I noticed that a lot of middle income homes don't have PCs, when they obviously could afford one. Parents are busy, either working or out of the home, so there is little time in between; also, there is high TV viewership. As a result, having a PC was traditionally seen as a low priority. Yet mobile penetration is very high, now over 70%. Children are the drive for ADSL growth, as the new generation need computers and internet access for their education, in addition to messaging/communications and not least, entertainment - this is the area we are focusing on.

We donated 100 million YTL for the construction of schools in 2006, and will do the same again in 2007, with a second 100 million YTL donated from Turk Telekom. We also have a 600,000 teacher PC literacy program, which we are doing in collaboration with Intel - a very important program for us. Our next step is to work on education content.

We have released some PC support programs along with our ADSL sales. The PC can be bought through the help of a number of banks, with a 24-36 months payment plan. With this we have hit about 3 million ADSL lines in early 2007, and we believe that at the end of this year we will have well over 4.5 million. I believe the market can hold up to 5-5.5 million total ADSL lines in the near term, and can grow even more if taxation is dropped (15% special communications tax), and may then reach 8.5 million. Of course, prices of ADSL will go down. We have already dropped the price, and this year we have filed for an application to massively reduce the top end prices, and we expect approval before the end of February 2007.

I personally believe that with the tax reduction the government needs to make in this sector, the capacity of the market can reach 8.5 million, which may be further motivated with such tax reduction, as the entry level price now of 29YTL (including full taxes) is as low as we can go.

With regards to the mobile situation, the taxation is even higher. The special communications tax is 25% (and total level reaches 58%, including VAT), and this obviously is far too high, being the highest in the world. The Minister of Transportation has been fighting for it, and we support him fully.

2005 and 2006 were important years in terms of increased competition and the liberalization of the sector. What role does Turk Telekom play in this new environment?

When we came into the company we did not want to play the delaying practise you normally see in other markets, because we knew that licenses were issued in 2004/2005. The pre-privatization management team of TT didn't want to commit much before privatization - Let's face it: they wanted to maximize the value of what they were selling.

When we came in, it was not sustainable for us to maintain that approach. We committed to pro-competition and we proceeded to sign all the agreements with the alternative operators. Since we came to the company we lost around 25-30% in long distance traffic, which is in line with our target for this period. Competitors were undercutting us by 40-50%, and I said to the team to back off, and let them pick up customers. The reason is that we need to rebalance our 'full tariff plans', and avoid a piecemeal approach, ie, reacting to competition in specific traffic routes. The difficulty is that we lose money on access (ie fixed monthly fees don't cover our costs), and making higher profits on long distance calls - this was not sustainable, as we would then suffer much higher market share, 'unfairly'.

We have taken a good step to rebalance our tariffs on voice, and launch these regulatory approved prices by March 1, 2007. So we have cut a bit of our 'access deficit', and can afford to be much more competitive. The competing operators are not very happy with this, as it is

more difficult for them to compete now, but they have had a very easy period of competition so far, and now they have to work harder, increase their investments, and offer better services.

On the international side we have lost even more market share, we are somewhere close to 40 %, having lost around 55-60%. Again, we didn't fight back on price at all. It was done deliberately for our competitors to pick up customers. We are much more competitive now, and hope to grow the residential market.

On the ADSL side, our competitors were not able to build strength. SuperOnline is our biggest competitor in this market, but there seems to be a strategy issue related to their owner, because they are controlled by TurkCell. TurkCell started another company called Telcom, so we basically we don't know who are our competitors now: is it SuperOnline or Telcom?

Recently, we outbid Telcom on a fiberlink into Bulgaria. We are not interested anymore in offering fiberlink to the domestic market, where they won, and we are happy about that, as it increases competition.

There are other competitors: Dogan group has launched a good product called Smile, which shows promise. Of course, we have other competitors like Borusan and Koc, which are very strong on the corporate market.

Of all competitors, 6 are the stronger ones, who have clear strategies of where they want to be, and are owned by financially strong holdings, who can back up their plans. However the others are just 'cherrypicking': they are not investing enough money into the business. We expect most of the ADSL competition to be based on reselling. Overall, we hope the target loss is at least 20% at the end of this year, so that our competition can improve, but it's tough, since they do not want to further invest their money in order to grow.

You bought a state-owned company. Do you find that some operational constraints still persist today? Which ones?

One of the major operational restrictions that the company has suffered before is the history of stringent public tender rules, which are very difficult to follow particularly in such areas as service distribution, marketing and advertising.

They had to follow tender procedures which are very cumbersome for such dynamic areas of the business. Also, such processes are prejudicial to selecting the lowest price, regardless of other considerations. You can't compare the prices in such limited extent – you have to ensure that it is the right product? Secondly, considering the cost of ownership should be considered (ie, life-cycle cost); this are very complicated to deal with under the old

procedures, so that the end result used to be choice of the lowest price, and in some cases, the wrong result.

The underlying culture remains the same: to follow processes. We want to win people over because then they will do something they are convinced to do, not instructed to do.

The first lesson I learned was to extend my patience limits. And if you come from an operationally dynamic telecom sector, the last thing in the world you have is patience. So that was a major change of gear for me personally.

Through this change we now have a much stronger team, sharing the challenges. I think we have done reasonably well, plus we have a number of Turkish people in the company that came from international companies. We have expats, such as British personnel coming from BT, who have been working for us for many years, and also some people from the Middle East, who have worked with us on other projects over the past years.

The principle is: if you want to do your best, you have to forget that you are in Turkey, and just do what is best. We are benchmarking to the best operators in the world: we reward 'targets' and 'results', as oppose to 'procedural compliance' and 'effort'. Overall, I think there is a spirit of continuous improvement, and I am a very excited 'patient' new man.

I listen a lot. And also all my people are trained to do so. An important thing is that we work in Turkish, and not in English. When we first entered the company, I told the top management (total of around 18 persons): if you don't speak English, don't think you will be disadvantaged - you will not be. And if you do speak English, don't think it's an advantage for you either.

In Turkey the education system includes English, but they don't use it in 'spoken' form. Articulate people prefer to express themselves in Turkish, although they understand English – ie, they prefer not to risk speaking English, as they cannot express themselves as well.

Unfortunately, I don't speak much Turkish, despite being married to a Turkish woman for 18 years. We lived in England, and English is the language in our home. My main language is Arabic, and she speaks Turkish as hers. I should be learning Turkish this year – I hope.

Now the pressure is also on you, since a public offering is expected to happen this year (2007). Are you committed to making TurkTelecom a good sell?

My job is to build value in this company. We have restructuring and reorganization plans. We have new people joining us: We are building a new headquarter, and are strengthening our operational base in Ankara. We also have really tough targets set for 2007, so I hope that this

year we will begin to achieve those targets. 2006 was more of a transition year, where we found ourselves slipping on some targets. In 2007 there is no room for slippage.

In terms of listing the company, one must take into consideration the account preparation: When we walked into the company, there were no international standard accountants, so we had to use a lot of consultants. Last year we were late, but this year we are on target, and I am proud to say that we have our accounts ready on time. We have a data warehouse we have ourselves, in order to ensure proper data and access to measurable information! Otherwise we can't hold people accountable!

Obtaining approval for our voice tariff rebalancing was a very crucial step, as without rebalancing, the financial performance is critical, particularly due to exposure to unfair competition, and suffering from large access deficit. This was a crucial step for the IPO.

Many of Turkey's captains of industry are investing heavily in their R&D, technology, ICT platform. You can really see Turkey is building a knowledge-based economy. How do you see your source of income developing over the next years? What other products are you bringing to the market?

I would like to start with mobile – we own 81% of a mobile company, and 3G licenses may happen this year. We have really aggressive growth targets. AVEA is a company with a difficult history: a merger of 2 companies and co-control management. Now we have single source management team.

This year will be a very important turnaround year for Avea. We are investing heavily in infrastructure, increasing coverage and capacity in addition to new value-added services, with an exciting portal. AVEA has around 14% market share but in terms of coverage it improved materially last year. Although TurkCell has the largest coverage, we are now a good match in terms of quality, and in a lot of areas are even better; this is a great achievement after only one year of operation, and \$300 million investment.

We have a challenge because we also carry twice the number of minutes of use per customer (in comparison with Turkcell). If you take our customer base (around 8 million customers), it's equivalent to 16 million TurkCell customers in terms of carriage. Basically it means 50% of Turkcell today in terms of minutes carried. This is enormous! The unlimited usage that we gave to institutions are not sustainable, and we began to redress that so that we unlock some additional value from existing investments.

On the fixed line side, traditional voice revenues are coming down. With the rebalancing of prices, this year we are expecting the revenues to go up 2-3%, or at least stop the drain. On the ADSL side we expect huge growth.

In terms of new products we are working on IPTV offering and also on a fixed-mobile convergence product, using Wi-Fi and GSM. AVEA was first to market with Blackberry service, including GPRS and also EDGE, the latter being throughout the network, after the successful replacement of equipment down to two vendors.

We have some other products and services for the market: we have some cross-selling plans between ADSL and mobile.

There are other services as well: we have a VOIP plan for some of our corporate customers who have demanded it. We purposely also delayed the launch of EDP mature offering, and again it wasn't to stay out of the way from our competitors, until we are ready. Rather, we are concentrating on the residential market, where we have a major upside potential. However, we have some special offerings for SMEs, and will launch these very soon.

We have achieved some very good results on fixed SMS, which is better than I expected. We have also had good results with the 'family card' for which we are now close to 750,000 users; it's a very interesting concept.

Voice mail was launched recently, but that was done for convenience to our customers, and not to generate revenue.

Our capital expenditure plan is 1.3billion YTL this year.

What strategy are you developing to enter new markets in the region?

We have a business development unit which is supported from my team at Oger Telecom. We are looking at a number of acquisitions: we would first like to acquire some technology / service companies, not to support our internal business, but for market growth, domestically and internationally. We aspire to be a 'full-service' company, and to offer strong after-sale support including: IT services, integrated telephony/data voice/messaging, image/video, in addition to general operational and business support systems.

That will be a challenge to achieve, but we are confident. Internationally, we are looking at 3 specific opportunities at present. We are hoping to close at least 2 important acquisitions this year.

The OgerTelecom IPO was cancelled. Can we expect it in the near future, or is it set for the longer term?

OgerTelecom IPO was not done for generating cash – the controlling shareholder wanted to have a listed company in their group. There was no capital increase. They aspired to

transform from a family owned private entity to a public company. At the time there were concerns about the 'after market' due to volatility in the regional. This is a shareholder decision, and not really a management matter. Our job is to assist, and they choose the timing. Of course, the shareholders would like to get a good price. Later this year, or next year seems more likely, but again it's their decision.

What business opportunities would you recommend to foreign investors here?

TurkTelecom is the 13th largest operator in the world in terms of switched lines (ie PSTN). You asked me about acquisitions. Special international acquisitions are an important step towards development. We want to increase our core competencies in particular on the service delivery side, because that is the area where we believe we can attract the right quality people at a competitive price, and be able to export this to a number of potential expansion operations. It is a combination of certain products that will be very competitive in quality and price, and in terms of support services that will be also unbeatable. This will apply to certain markets in the Middle East, and in South-Eastern Europe, and Central Asian Republics.

I'm looking at a major revenue boost from these opportunities. We will be partnering with some other companies, in addition to acquisitions, which we will integrate into our operations. Strong win-win partnerships. That is what we need to build our strategic relationships, coupled with best practice.