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**Outward Internationalisation of Russian Leading Telecom  
Companies**

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## **ABSTRACT**

The paper deals with the outward internationalisation of Russian leading telecommunication companies (MTS, VimpelCom, and MegaFon). Both target foreign markets and entry strategies of the mobile operators are investigated. Outward internationalisation of the companies under review was preceded by growth and expansion within the national boundaries. The first market entries occurred in 2001-2002, when key regional telecom markets of Russian Federation were almost saturated.

From the very start Russian leading mobile operators focused on the CIS countries. This approach was based both on the economic and political ties inherited from the Soviet era and on the attractiveness of the CIS states as fast growing markets. Relatively low penetration rate and rapidly increasing subscriber base presume significant future opportunities for telecom sectors. Knowledge of business environment and practices in the CIS countries, which were quite similar to those in Russia, favoured the entries. Competition on most target markets is comparatively low due to weakness of most local operators and presently small interest of large Western companies in the CIS states.

With the only exception of Belarus (where a joint venture was established) acquisitions of local mobile operators constituted the basic entry mode. Russian mobile operators contributed much to the development of telecom sector in the CIS countries. While operating in Belarus, Ukraine, Kazakhstan, Uzbekistan, Turkmenistan, Tajikistan these cellular companies demonstrate interest towards the markets of Kyrgyzstan, Georgia, Azerbaijan and Armenia. The paper argues that despite increasing competition entries to new CIS markets might be expected.

In December, 2004 one of the owners of MTS (AFK Sistema) made initial steps to enter Indian markets of cellular communications. Although the project is not yet finalised, it clearly indicates that outward internationalisation of Russian mobile operators expanded beyond the boundaries of post-Soviet area. The paper investigates the growing international ambitions of the companies under review.

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## 1. INTRODUCTION

The outward internationalization as a phenomenon was investigated by many researches starting from the 1960-ies. Among them one could mention R. Vernon (Vernon, 1966), J. Johanson, J.-E. Vahlne (Vahlne & Johanson, 1990), J. Dunning, (Dunning, 1993), R. Luostarinen, L. Welch (Welch & Luostarinen, 1993), C.H. McMillan (McMillan, 1996) and many others. Russian companies started to invest abroad on a large scale quite recently creating a relatively new phenomenon for the world economy. However, there are already several investigations of that issue by Finnish researchers like K. Liuhto, A. Purju, P. Itämeri, P. Vahtra (Liuhto, Purju & Itämeri, 2000; Liuhto, 2001; Vahtra & Liuhto, 2004) and Russian scientists namely S.F. Sutyryn, E.G. Efimova, G.I. Dudarev, P.N. Filippov, V.G. Survillo (Sutyryn & Efimova, 1996; Dudarev & Filippov, 2002; Survillo, 2003). It is likely that this process would arise interest among the economists as it develops, involving more and more companies and extending to new industries.

Until mid-1990s outward internationalisation of Russian firms mostly kept the form of exports as nationally based companies were not financially and organisationally strong enough to invest abroad. Emergence of large holdings able to expand their operations over the national borders led to first entries to foreign markets by Russia based companies. A majority of them belonged to fuel industry, non-ferrous and ferrous metallurgy and were deeply involved into international trade. In certain cases these companies entered the foreign markets following their trade flows, either exports or imports. For instance, YUKOS (fuel industry) acquired an oil processing plant in Lithuania in order to integrate it into the vertical structure and production chain of the holding and diversify its exports. Russkij Aluminij (non-ferrous metallurgy) which had bought an alumina factory in Nikolaev, Ukraine, tried to weaken its dependence on imported input - a basic raw stuff for aluminium production. Another examples show that large exporters made cross-border acquisitions first of all to get access to other markets rather than to integrate the purchased companies into their production structure. One could name, for example, Severstal and NLMK ferrous metallurgy companies, which were seeking the way to steel markets of North America and EU respectively<sup>1</sup>.

In the sector of cellular communication outward internationalisation might take place first and foremost in a form of ‘commercial presence in the territory’ of other country (as among four possible ways to execute foreign trade in services defined in GATS only this one is basically

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<sup>1</sup> To achieve this goal Severstal acquired a metallurgical company in the US and NLMK did the same in Denmark.

applicable to the industry under review). Telecom companies during the 1990-ies were expanding on the Russian market. The growth of the sector and the consumer base was favoured by the country's numerous population and comparatively developed communication infrastructure, inherited from the Soviet past. Foreign investors contributed much both financially and technologically to the emergence of the largest Russian telecom operators. That refers to the leaders of Russian telecom: MTS and MegaFon, which were established in co-operation with German and Scandinavian investors respectively. Cellular telecommunications in Russia developed fast, following the global growth tendency in the sector. Being "born" in early 1990-ies, telecom companies rapidly reached the stage of maturity necessary to start the foreign market expansion. The companies established co-operation ties with the operators from the neighbouring countries in order to provide roaming services to their Russian customers, who travelled abroad. This step preceded full-scale foreign market entries and created certain prerequisites for outward internationalisation. The latter, in turn, became an obvious necessity as only entering new markets enabled Russian telecom companies to support their successful performance.

## **2. RUSSIAN MARKET OF MOBILE SERVICES**

From the technical point of view the Russian mobile market is divided according different communication standards. The Ministry of Information Technologies and Communications of the Russian Federation issues licences in the following ones: NMT-450 (Nordic Mobile Telephone), AMPS (Advanced Mobile Phone service) (both analogue), DAMPS (Digital Advanced Mobile Phone Service), GSM (Global System for Mobile communications) and standards using CDMA (Code Division Multiple Access) technology (digital). Until 1996 only analogue standards were used in Russia. DAMPS and GSM digital networks, based on TDMA (Time Division Multiple Access) were introduced in 1996. Application of CDMA networks has been permitted in Russia also since 1996. Until recently it had a special status of the fixed cellular standard, although it was designed for mobile telecommunications. It has been used for creation of wireless communication systems between stationary subscribers, in particularly first and foremost for telephonisation of isolated areas. At the moment the GSM standard has a federal status and covers almost all the regions of the country.

The simultaneous existence of various standards under the conditions of limited demand and the huge geographical size of Russia creates obvious barriers for covering a significant part of the country's populated regions with a unified network. Regardless of specific impact on Russian mobile telecommunication system, this situation results in the fact that investments are dissipated between competing standards. At the same time, one could observe certain changes in relative usage of various standards. Experts predict further reduction of the AMPS/DAMPS share and growth of the GSM one on the Russian cellular market in coming years. These developments are basically in line with a worldwide trend. In addition to that, one could expect certain growth in CDMA share, but it still remains low. So, it does not look like any surprise that the companies, which operate in GSM standard are strong enough to expand their activities at foreign markets.

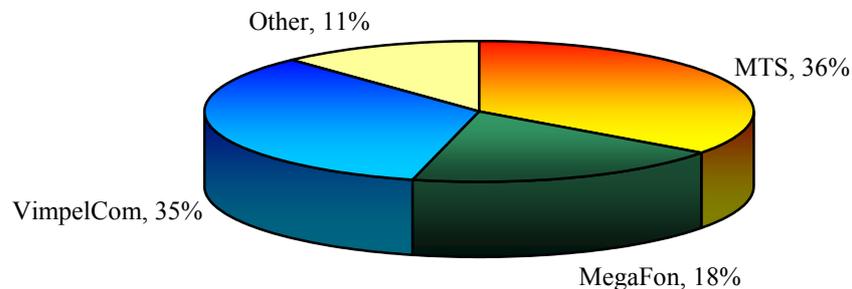
During last several years the number of mobile service subscribers in Russia increased dramatically. Before 2000 penetration rate in Russia did not exceed 5%, the price of the services was extremely high, and many national regions were not covered with the mobile communication network. By the beginning of 2005, according to the most optimistic estimations, penetration rate reached 51% (compare to 25% in the beginning of 2004 (Averin & Fomina, 2005b)), the total amount of telecom service subscribers in Russia in all standards has reached 74

million. It's also worth mentioning that service providers introduced a wide range of so called "budget" tariffs, and the number of covered regions increased as well.

At the same time the difference between the Russian regions is really large. On the one hand, Moscow with penetration more than 99% and St. Petersburg with 89% are well ahead Japan or USA national averages (Rosbalt, 2005a). On the other hand, in about twenty regions penetration rate is still below 10%. In addition to that base station density in some areas is still very low. More than that, one could expect that in a medium run regional disparity will remain substantial enough. Certain trend towards convergence might reveal itself gradually and in a long run, resulting from more intensive competition both in the most developed areas and in other parts of the country.

Three companies dominate on Russian mobile service market: MTS, VimpelCom and MegaFon. All together, currently they control almost 90% of the market.

**Figure 1. Market share of Russian mobile service providers in terms of subscribers (December, 2004)**



*Source: J'son & Partners*

MTS is a number one among three largest telecom service providers in Russia. Its market share equals to 36%. Two other majors – VimpelCom and MegaFon are in command of 35% and 18% of the market correspondingly.

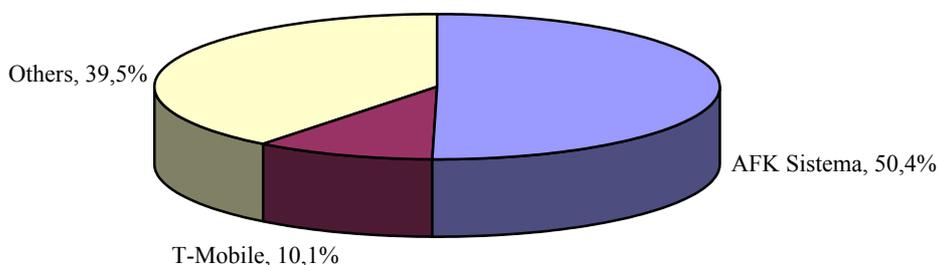
**MTS (Mobile TeleSystems)** is a largest telecom service provider in Russia, operating in GSM standard. In Russia, the number of its subscribers exceeds 26 million as for the beginning of

2005 (MTS, 2005). Having licenses to provide telecom services in 87 Russian regions (out of 89) the company currently runs its operations in 61 regions. In the third quarter of 2004, the revenue of MTS totalled over one billion US dollars, net profits approached USD 340 million and EBITDA was over USD 630 million. Market capitalization of the company amounted to USD 13 billion by the end of 2004.

MTS began its operations in October, 1993. The company was founded by the Moscow city fixed-line operator MGTS (Moscow City Telephone Network) and several other domestic shareholders, on the one side, and DeTeMobil (Deutsche Telecom's subsidiary) and Siemens, on the other side, as a closed joint stock company. Russian and German shareholders owned 53% and 47% in the company, respectively. In early 1995, AFK Sistema, a Moscow-based financial group, consolidated the stakes of Russian shareholders; at the same time, DeTeMobil purchased the Siemens' stake. The history of MTS as a public company began in 2000 with IPO on the US market.

The latest changes in MTS ownership structure took place at the end of 2004, when Deutsche Telekom sold 15% of Mobile Tele Systems on the off-board market. At the moment, the controlling stock belongs to AFK Sistema while the share of Deutsche Telekom (now represented by T-Mobile company) decreased down to 10%. Nearly one per cent of the company's shares belong to its management. The rest is traded on NYSE, European off-board markets and MMVB (Moscow Interbank Currency Exchange).

**Figure 2. The ownership structure of MTS (January 31, 2005)**



*Source: MTS (2005)*

**VimpelCom** (Beeline trade mark) with 35% of the market share is the second largest mobile service provider in Russia. The company provides services to more than 20 million subscribers in 72 regions of Russia and Kazakhstan (VimpelCom, 2005).

VimpelCom is not a typical Russian company. In contrast to many others, it was created by a group of researchers in advanced technology for radio electronic equipment of a state-owned enterprise. One a high-ranked managers Dmitri Zimin leded the team. The company was formed in 1992.

Due to the lack of influential lobbyist the company had some difficulties in establishing its network. Thus, at the very beginning of operations, VimpelCom (according to Russian regulations at the beginning of 1990s the ministry of Telecommunications issued only one licence per standard in each region) failed to obtain a license for the GSM 900 standard and ended up with AMPS. In 1995 the company obtained a licence for GSM 1800. By the time VimpelCom got the GSM 900 licence in August 1998, its main competitor MTS, which obtained a GSM 1800 extension to its licence in 1996 had already built a vast two-band GSM 900/1800 network in the Moscow Region. Since 1996 the company was listed at New York Stock Exchange. The IPO brought VimpelCom USD 110.7 million as the share price soared by 48%.

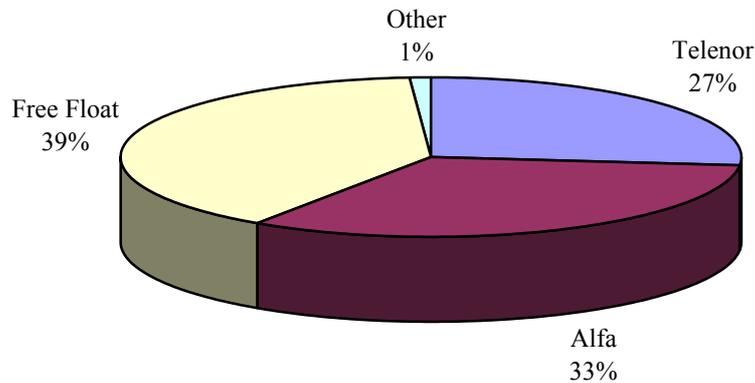
August 1998 economic crisis resulted in heavy losses. Under the circumstances in order to gain appropriate dynamics the company decided to form a partnership with Norway's Telenor in December, 1998. The latter paid USD 162 million for 25% of VimpelCom voting stock. The funds received from Telenor enabled VimpelCom to speed up the construction of the dual-band network, and by the end of 2000 the company managed to reach parity with MTS in terms of coverage in the Moscow province. In the meantime VimpelCom kept on its expansion to other Russian regions.

In addition to financial resources, the company got managerial experience from a Norwegian partner, as some of the key positions were taken by Telenor's managers. The latter previously had helped to develop Norway into one of the world's most penetrated wireless telecommunications market. One might argue that VimpelCom succeeded in implementing expertise of the partner company towards its business practice. Telenor's experience in new product development, value added services and marketing techniques, helped to secure for VimpelCom strong competitive position in Russia.

In May 2001, VimpelCom made a strategic deal with Alfa Eco, a branch of Russian holding company Alfa Group, selling it a blocking stake. According to some experts, the involvement of

Alfa strongly contributed to the successful development of the company under review. Figure 3 shows current ownership structure of VimpelCom.

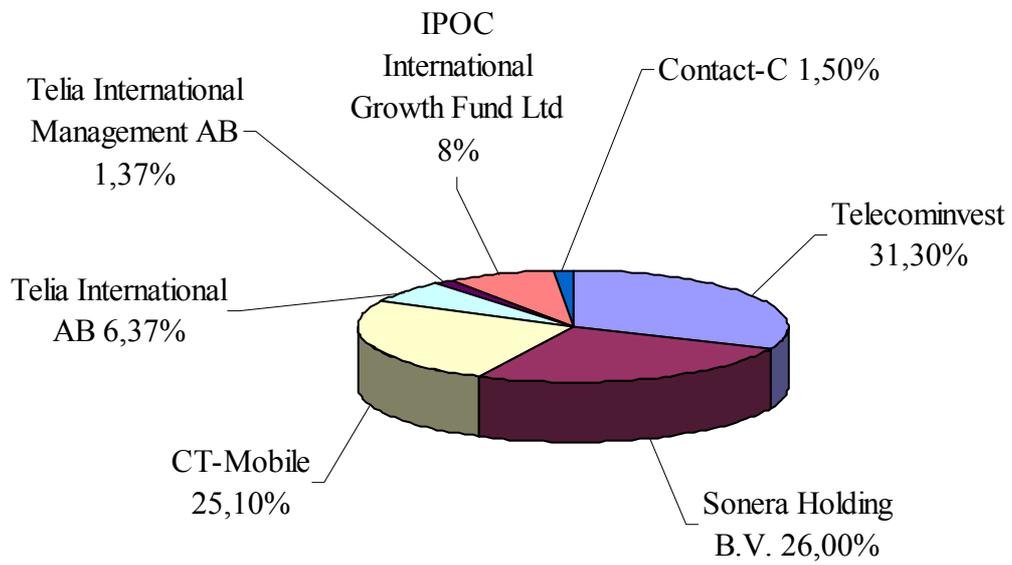
**Figure 3. The ownership structure of VimpelCom (December 1, 2004)**



*Source: VimpelCom (2005)*

**Open Joint-Stock Company MegaFon** is the first Russian national provider of mobile services in GSM 900/1800 standard. The project was launched in August, 2001 after the merger of the oldest mobile service provider in Northwest Russia, NorthWest GSM (founded in 1993) and some mobile service providers from various Russian regions (Sonic Duo, Moscow; Mobicom-Caucasus; Mobicom-Centre; Mobicom-Novosibirsk; Mobicom-Kirov, MSS-Povolzhie; Voljzsky GSM; and Uralsky GSM). The shareholders of MegaFon are Telecominvest, Sonera Holding B.V., CT-Mobile, Telia International AB, Telia International Management AB, IPOC International Growth Fund Limited and Contact-C.

**Figure 4. The ownership structure of MegaFon (February 1, 2005)**



*Source: MegaFon (2005)*

### **3. RUSSIAN MOBILE COMPANIES' GENERAL APPROACH TO NEW MARKET ENTRY**

During the 1990-ies Russian telecom companies increased their coverage area by regional expansion within Russia. In 2001-2004 the companies started the outward investment stage of internationalization by expanding to the neighbouring CIS countries. The first was MegaFon in 2001 and then came MTS, which got the license for operations in Belarus in autumn 2001 and entered the country's market during the following year. The last was VimpelCom: the company started to invest abroad in 2004.

For any company in the mobile communication sector, entering the new national market means extending its network largely through usage of infrastructure already existed in the country of destination. From that point of view the higher the level of technological development the more attractive is the target market. This factor also strongly favours acquisitions of existing companies, which operate on local mobile communications market and have their own infrastructure and subscriber base. In addition to that, regulatory factor is rather important for mobile communications sector as the state (in particular due to security reasons) quite often tries to protect it from foreign operators. In general, combination of technological and regulatory considerations largely predetermines foreign market entry mode for the companies in the sector.

Russian telecom companies started their expansion abroad with several neighbouring countries – former republics of USSR. The reasons for choosing these target markets could be subdivided in two basic groups.

The first group of reasons relates to historical and cultural traditions, common infrastructure network inherited from the Soviet era, and relatively similar business practices. In addition to that one should take under consideration geographical proximity, which clearly favoured expansion (at least initial one) towards close neighbours. At the same time in this case the latter is a rather controversial issue as several target markets (in particular, Tajikistan, Turkmenistan and Uzbekistan) are located relatively far from main Russian economic centres.

Overall mobile services subscriber's base in the former Soviet republics today exceeds 75 million people<sup>2</sup>(Averin, 2005). The region is obviously large and fast developing market where the competition is still rather modest (with exception of the Baltic States), while the opportunities are substantial. The countries under review started the economic reforms right after obtaining the sovereignty in 1992 and belong to transition economies. Markets of this area, however, do not form an entity, as they differ tremendously from each other both by subscribers'

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<sup>2</sup> Estimations for the end of 2004.

base potential and by current penetration level. Initially it seems reasonable enough to treat separately at least two regional submarkets: the CIS countries and the Baltic States.

**Table 1. Mobile subscriber's growth in former Soviet republics (CIS countries and the Baltic States)**

Country	Number of subscribers, September 2004	Number of subscribers yearly change (%), September 2004/ September 2003	Penetration rate (%), September 2004
<b>Armenia</b>	150 600	80.1	4.5
<b>Azerbaijan</b>	1 419 400	32.8	18.0
<b>Belarus</b>	1 856 300	115.4	18.0
<b>Georgia</b>	893 700	43.7	18.2
<b>Kazakhstan</b>	2 203 600	86.5	13.1
<b>Kyrgyzstan</b>	247 200	161.0	5.0
<b>Moldova</b>	654 700	49.1	14.7
<b>Russia</b>	56 106 140	88.6	39.0
<b>Tajikistan</b>	95 180	637.3	1.4
<b>Turkmenistan</b>	13 650	35.0	0.3
<b>Ukraine</b>	10 299 100	10.3	21.6
<b>Uzbekistan</b>	467 100	91.5	1.8
<b>Estonia</b>	1 197 600	156.4	85.4
<b>Latvia</b>	1 502 770	23.7	64.4
<b>Lithuania</b>	2 830 600	41.6	79.0

*Source: Calculated from: European Mobile Communications Report (EMC), 2003, 2004*

The Baltic States are the leaders in the area under review in terms of penetration level. In Estonia the penetration reached almost 85%, in Lithuania it is about 80%, and in Latvia 65%. Taking into consideration relatively small population of these countries and level of competition higher than in the CIS, Russian mobile service providers do not have that many incentives to enter this submarket today. Another important factor relates to the recent EU enlargement. After joining the alliance Baltic States introduced its rules and regulations on their territory. That creates additional barriers for the expansion of Russian companies. Political factors here could be also considered as rather significant. The existing tension between Russia and the Baltics sometimes leads to extra barriers for economic co-operation. Today local companies and large European,

mostly Scandinavian, mobile operators dominate the market of the Baltic States. Nevertheless, one of Russian telecom leaders MTS shows certain interest to the Latvian market.

Presently the main target markets for Russian mobile operators are the CIS countries. Integration within the alliance is a strategic target for Russia. Despite all the difficulties, political relations between most of the CIS countries tend to develop positively. Considering the high role of state in the mobile communications sector Russia's political ties within the alliance favour co-operation and help Russian companies to penetrate regulatory frontiers (that is especially important in cases of Belarus, Uzbekistan, Tajikistan, Kazakhstan and Turkmenistan). Moreover, internationalization to the CIS countries for the Russian mobile operators actually fits 'follow your consumer' strategy. Many Russian companies from various sectors of economy being corporate subscribers of telecom companies in the country have already entered markets of CIS countries and actively develop economic co-operation in the area. The aforementioned co-operation in providing roaming services to companies' clients abroad also enhanced Russian mobile operators to enter CIS markets as human migration inside the alliance is very intensive.

Another group of reasons for expanding towards the CIS is based on present developments in the target markets. Despite their heterogeneity the countries under review have one strategic common feature, namely rapid economic growth. It is reported during the last five years and follows a dramatic decline of the 1990-ies.

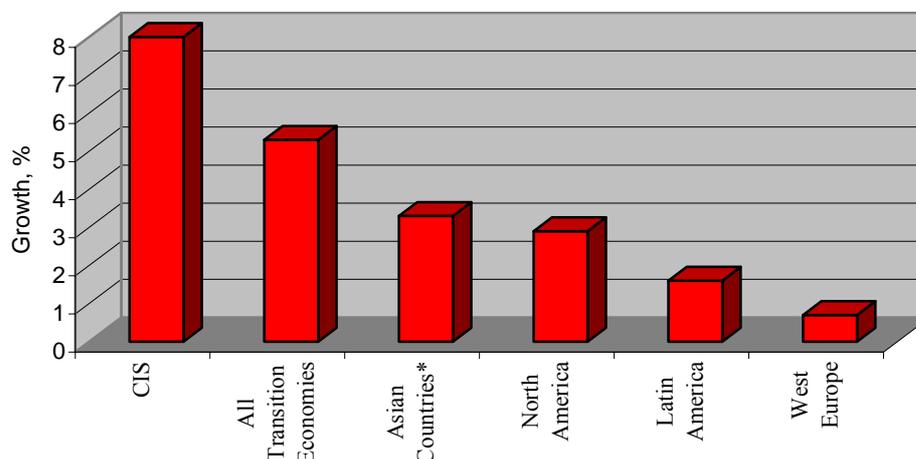
**Table 2. GDP growth in CIS countries**

	1998	1999	2000	2001	2002	2003
<b>Russia</b>	-5.3	6.4	10.0	5.1	4.7	7.3
<b>Ukraine</b>	-1.9	-0.2	5.9	9.2	4.8	8.5
<b>Uzbekistan</b>	4.4	4.4	3.8	4.5	4.2	4.4
<b>Kazakhstan</b>	-1.9	2.7	9.8	13.5	9.8	9.2
<b>Belarus</b>	8.3	3.4	5.8	4.7	5.0	6.8
<b>Azerbaijan</b>	10.0	7.4	11.1	9.9	10.6	11.2
<b>Tajikistan</b>	5.3	3.7	8.3	10.2	9.5	10.2
<b>Kyrgyzstan</b>	2.1	3.7	5.4	5.3	0.0	6.7
<b>Georgia</b>	3.1	2.9	1.8	4.8	5.5	8.6
<b>Turkmenistan</b>	...	...	...	...	...	16.9
<b>Moldova</b>	-6.5	-3.4	2.1	6.1	7.8	6.3
<b>Armenia</b>	7.2	3.3	5.9	9.6	12.9	13.9

*Source: Gaidar, 2005*

The economies under review tend to constitute the fastest growing area on the globe. While in 2003 the global average GDP growth rate was 2.5% (WTO, 2004), the same indicator for CIS was 8.0%, and it was higher than for any of the regions (and contributed much to the remarkable result for all transition economies – see Figure 3).

**Figure 3. GDP growth in various regions of the world in 2003**



\* - excluding Peoples Republic of China; it is regarded as a transition economy here

Sources: Intergovernmental Statistical Committee of the CIS Countries, 2004; World Bank, 2004

Telecom industries of the reviewed economies demonstrate growth rates which are even higher than that of GDPs. All this factors created obvious incentives to enter these markets for a number of large telecom companies, among which Russian operators take the leading positions. Relevant information is depicted in Table 2.

**Table 3. Ten leading mobile services providers in CIS**

Company	Country of origin	Countries of operation
MTS	Russia	Russia, Belarus, Ukraine, Uzbekistan, Turkmenistan
VimpelCom	Russia	Russia, Kazakhstan
MegaFon	Russia	Russia, Tajikistan
Fintur	Netherlands	Kazakhstan, Azerbaijan, Georgia, Moldova
TELE2	Sweden	Russia
Kyivstar	Ukraine	Ukraine
Uralsvjasiform	Russia	Russia
SMARTS	Russia	Russia
MDC (VELCOM)	Belarus	Belarus

Source: calculated from Averin, 2004

However, CIS as the target market has certain specific demerits. One is the threat of political instability in several countries that might lead to violation of property rights or even to deprivatisation. In some Central Asian republics the property rights (including foreign acquisitions in telecom sector) are to a big extent based on the political dominance of ruling elite and may be considered illegitimate in case of regime change. Moreover, the same threats exist even in Ukraine or Belarus<sup>3</sup>. Another disadvantage relates to low absolute level of economic development and per capita GDP in most of the CIS countries.

**Table 4. Basic macroeconomic indicators of CIS countries**

	Territory, thousand square km	Population, million	GDP per capita, 2003, USD
<b>Russia</b>	17 075.2	143.4	3023.0
<b>Ukraine</b>	603.7	48.4	1022.7
<b>Uzbekistan</b>	447.4	25.6	386.7
<b>Kazakhstan</b>	2 717.3	14.9	1993.3
<b>Belarus</b>	207.6	9.9	1767.7
<b>Azerbaijan</b>	86.6	8.2	865.9
<b>Tajikistan</b>	143.1	6.3	206.4
<b>Kyrgyzstan</b>	198.5	5.1	333.3
<b>Georgia</b>	69.7	5.1	764.7
<b>Turkmenistan</b>	488.1	4.9	1224.5
<b>Moldova</b>	33.8	4.2	476.2
<b>Armenia</b>	29.8	3.1	903.2

*Sources: Intergovernmental Statistical Committee of the CIS Countries (2004); World Bank (2004)*

A third demerit is substantial heterogeneity of mobile communication services markets in the CIS countries, which mainly results from current variety in standards of living. For example, Russia has GDP per capita 15 times higher than Tajikistan. Big and potentially promising markets like Uzbekistan have low penetration level first and foremost due to poverty of majority of population and absence of middle class.

Another important issue is the chronological sequence of market entries. One might suggest that, other things being equal, the markets with higher incomes, larger subscriber base and better communication infrastructure will lead this sequence. With reference to outward

<sup>3</sup> Examples may be seen below.

internationalisation of Russian telecom companies only one of three leaders (MTS) so far had entered more than one market. In this case the suggestion seems to be a correct one: first entries were to Belarus and Ukraine, while the next steps of the company's outward internationalisation was to Uzbekistan and Turkmenistan which are obviously less developed economies than the aforementioned ones. However, two other Russian telecom leaders (MegaFon and VimpelCom) had made yet only one market entry each, so no sound conclusions could currently be made about them.

## 4. MAJOR TARGET MARKETS FOR RUSSIAN TELECOM COMPANIES

### 4.1. RUSSIAN TELECOM COMPANIES ENTER THE CIS

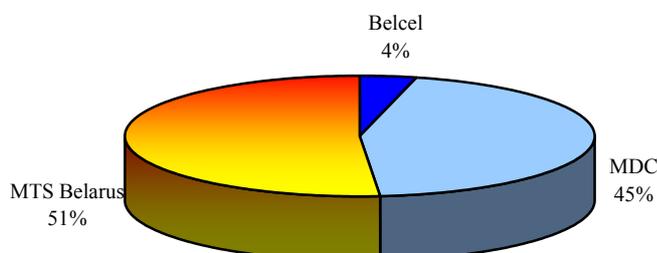
#### 4.1.1. Belarus

Belarus happened to be the first CIS target destination for MTS – the company with the highest level of internationalisation among Russian mobile service providers. With its population of nearly 10 million, Belarus is the fifth largest country of the alliance. The population density is some 50 people per sq km. GDP growth rate varied from 3.4% in 1999 to 6.8% in 2003. In 2003, GDP per capita amounted to almost USD 1800 (the third place among the CIS countries).

Belarus has lagged behind most East European transition countries in developing mobile communications. It was the last state in the region to introduce GSM cellular digital standard, having relied between 1993 and 1999 on an analogue cellular phone service. Mobile phone penetration has nevertheless increased rapidly during recent years. In particular, the subscriber growth rate in 2004 amounted to 120% and totalled 2.5 million; penetration rate has reached the level of almost 25% (Averin, 2005).

Meanwhile, the potential of Belarusian cellular market has not been exhausted yet. Two companies strongly dominate Belarus mobile service market: MTS Belarus and Mobile Digital Communication (MDC). The third company, BelCel, keeps rather modest market share.

**Figure 6. Market share of Belarus mobile service providers (September, 2004)**



Source: *European Mobile Communications Report, 2004*

**MDC** operates GSM-900/1800 network under the VELCOM brand name. The company was set up in July 1998 as a joint venture between Belarus' state-controlled fixed-line monopolist Beltelecom (share of 31%), an armament and military equipment exporter Beltekhexport (share of 20%), and Cypriot SB Telecom Ltd (share of 49%).

MDC has base stations in all localities with population exceeding 10 000 residents. Its network covers 45% of national territory. During 2004, the company lost the leading market position it had enjoyed for more than five years. MDC market share decreased down to 45% in September 2004 from 56% in the beginning of the same year.

Meanwhile, the company announced the plans to regain its leading position in 2005. To achieve this goal it is going to invest at least USD 65 million in new base stations aiming to cover 100% of urban population and 65% of the total Belarus territory.

**BelCel** was established in May 1993 as a Belarus-British joint venture. Currently, the company belongs to the Netherlands' CIB BV (50%), state telecom operator Minskaya Gorodskaya Telefonnaya Syet (30%), state company Minskobltelecom (3%), and Infobank (17%). BelCel, operated NMT450 standard since 1993 and launched services using the CDMA2000 standard under the brand name Diallog since 2003.

MTS decided to enter the Belarus market via establishing of a joint venture with a local company. It was long-distance operator Mezhdugorodnaya Svyaz. **MTS Belarus** began its operations in June 2002 (GSM standard). Currently, MTS and Mezhdugorodnaya Svyaz hold respective stakes of 49% and 51% in the joint venture.

In 2004, MTS Belarus outran MDC and became the leader on national mobile market in terms of number of subscribers (more than 1.2 million by the end of the year), subscribers growth rate (56 and 38% correspondingly) and the territory coverage. Access to company network is available on half of Belarus territory with 93% of urban population. These results were positively assessed by the Russian mother-company, which claimed that more than two-year-long history of operations in Belarus appeared to be mutual beneficial for both partners.

Future prospects for MTS Belarus to large extent depend upon the ability of the company to compete successfully both with MDC and BEST. The latter has really ambitious expansion plans to cover 60-70% of the Belarus territory; including areas there other existing companies have failed so far to establish their presence (Sharova, 2004). While providing access to mobile

services for low-income groups and rural residents these activities correspond to Belarus social regional development policy. Under the circumstances the company might rely on various forms of governmental support, in particular on state guarantees in obtaining loans.

Generally speaking, political factor in a broad sense of the word is a very significant one for doing business in Belarus. This is particularly true for telecommunication sector. In particular, the Belarus Government constantly reveals its serious concern regarding capital flight. Accordingly, both MTS and MDC were accused of withdrawing of USD 20 million annually from Belarus. These accusations are largely groundless. In addition to their substantial contribution to wireless communication development in Belarus, MTS and MDC annually pay about USD 80 million of taxes (Sharova, 2004).

The attitude of the government is also crucial with respect to the plans of MTS to increase its stake in MTS Belarus up to 51% and afterwards seriously increase its investments. Previously the state had preferred to keep larger interest in telecom companies. At the moment CIB BV with its 50% is the only exception. So far investments of Russian partner into MTS Belarus have amounted to over USD 130 million since 2002 (Rosbalt, 2004).

In the nearest future, MTS Belarus aims at improving the quality of services by investing substantially in the network development. In 2005, MTS Belarus plans to extend the installed capacity up to three million numbers. To achieve the goal the company is going to purchase state-of-art equipment and launch additional base stations in all regional centres.

In June 30, 2004 the government of Belarus decided to initiate the birth of the third GSM service provider and announced a tender. The winner would get 49% of the new company and have to enter into a partnership with state fixed-line monopolist Beltelecom. Both VimpelCom and MegaFon were among ten international mobile service providers that expressed their interest to participate in the tender. However, some of them (e.g. MegaFon) after studying the documentation decided to quit. In the meantime the tender was cancelled and on October, 2004 it was announced that the fully state-owned Belarusian company Agat would be the second partner in the joint venture. A new company, Belarusian Telecommunication Network (BEST), was set up in November 2004. BEST has to start its performance in 2005. Despite the fact that VimpelCom has not succeeded so far at Belarus cellular market, the company claimed that it will try to use any opportunity to enter the country.

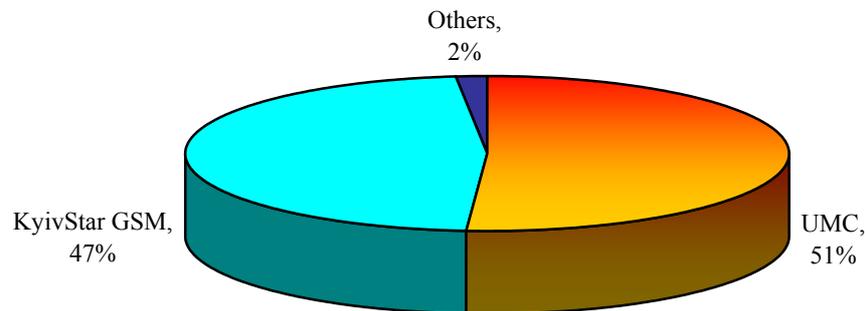
### ***4.1.2 Ukraine***

Ukraine was one of the most important target destinations for Russian mobile companies. Thus, MTS entered this market just a few months after Belarus. In terms of population, Ukraine is a second largest market in the CIS (close to 50 million people). The population density is also relatively high – 80 people per sq km. After eight years of decline since Soviet Union collapse, Ukraine has been experiencing economic growth since 2000. GDP growth rate in Ukraine was even higher than in Russia and varied from 6% in 2000 to over 8% in 2003. At the same time, GDP per capita remains quite low (slightly over USD 1000). This is far behind Russia and Belarus.

The Ukrainian mobile service sector is one of dramatically growing industries in the country. The number of subscribers has been increasing rapidly (by 140% in 2001, 60% in 2002, 80% in 2003 and 110% in 2004) (CIT, 2003). In September 2004, there were about 10 million mobile subscribers. According to mobile operators' forecasts, this figure could be more than 20 million by the end of 2005. The growth of the sector could be explained by two main reasons: low penetration rate of fixed lines (24%) and substantial price fall for mobile services. However, the penetration rate in Ukrainian mobile sector is still quite low; it is just crossed 22%.

There are currently five mobile operators in Ukraine. At the same time, the market in Ukraine is very similar to a duopoly model divided by two main players – Ukrainian Mobile Communications (UMC) and KyivStar GSM, which control together about 98% of the mobile sector. The remaining three mobile operators Golden Telecom (GT), Ukrainian Radio Systems (URS, traded as WellCOM) and Digital Cellular Communications (DCC) do not significantly influence the market.

**Figure 7. Market share of Ukrainian mobile service providers (September, 2004)**



*Source: European Mobile Communications Report, 2004*

**KyivStar GSM** was founded in 1994 as a joint stock company. The company began its operations in 1997. It belongs to Norway's Telenor Mobile Communications (54%), Ukrainian company Storm, controlled by Russian Alfa Group (40%), and local investor Omega (6%). The network of KyivStar covers the largest part of the Ukrainian territory and 87% of the country's population. Development plans of the company include substantial investments in order to improve quality of services.

Alfa Group gradually increased its share in KyivStar. Last purchase took place in July, 2003 when Storm bought 7.7% of the shares from the Norwegian company. The shareholders structure of KyivStar looks quite similar to that VimpelCom. It seems that Russian and Ukrainian operators might merge (Averin, 2004).

Other prospects of Alfa Group on Ukrainian cellular market could be associated with Golden Telecom Ukraine, a daughter company of Golden Telecom, one of leading Russian fixed telecom service providers. Alfa Group, being among of Golden Telecom's shareholders (40%) may use an opportunity to increase its influence in the country. In the meantime Golden Telecom Ukraine does not work much on the network development and its market share (in terms of subscribers it is very low). The actual performance of the company allows suggesting that Golden Telecom Ukraine prefers not to compete with KyivStar in mass segment, but to focus instead on customers with high level of income. More than that, the main field of specialisation for the company is fixed-line telecom services.

MTS entered the Ukrainian mobile market in 2002 via purchasing controlling interest of UMC (58% of shares). Step by step, the Russian company used to buy stakes from the other owners. At the moment MTS holds 99% of the Ukraine company directly and one per cent through its subsidiary PPT Telecom Kyiv. UMC was established in 1992 as a joint venture between national fixed-line operator Ukrtelecom (51%), TDC AS (Denmark), Deutsche Telekom (Germany), and Royal KPN NV (the Netherlands), each foreign company got 16% of the stake (Paul Budde Communication, 2002).

For the first eight years of operations UMC was the market leader. The trend changed in mid-2001, when the company faced network capacity problems and stopped to accept new subscribers for three months. KyivStar manage to use the opportunity to become a leader. At the end of 2001, the market share of UMC fell down from 55% to 46%.

When MTS decided to enter Ukraine mobile market, UMC was the second player. Brief history of the purchasing UMC by Russian company included several stages. In November 2002, MTS applied to the Ukrainian antimonopoly committee for permission to buy 58% of UMC and simultaneously to sign an option agreement to purchase the remaining 42% for some USD 140 million in 2003-2005. The first decision to sell UMC was taken by the Viktor Yushchenko government. In November 2002, MTS signed a USD 194 million-contract to buy the first share holding by the end of the year. This controlling stake in its turn consisted of three parts. Ukrtelekom sold 25% of state ownership for approximately USD 85 million. Two packages of shares of Deutsche Telekom and KPN were sold for USD 55 million each. Since March 2003, MTS began to consolidate UMC in its financial statements.

Then MTS signed an option contract with Ukrtelekom to acquire a 26%-share of UMC for almost USD 90 million. MTS took up the option in June 2003. MTS also signed an option contract to buy from TDC a 16%-share of UMC for a price not less than USD 55 million. This share holding was actually sold in July 2003 for some USD 90 million. Being the only owner of UMC, MTS in April 2004 decided to transform the mobile operator from a limited liability enterprise into a close joint stock company.

One could argue that the influence of MTS as an owner was rather positive for UMC. Managerial, financial and other types of input helped the latter to restore the leading position on the Ukrainian mobile market. Thus, the number of UMC subscribers as subsidiary of MTS doubled in two years and the growth rate was higher then one of Kyivstar for the same period. In 2004 the market share of UNC increased by 2.4% and one of KyivStar decreased by almost 1%.

At the same time, the share of Ukrainian mobile service provider in total amount of MTS subscribers reached 21% on 2004 (Averin & Fomina, 2005a).

MTS also invests intensively in network development. While UMC' total investments in ten years period amounted to over USD 450 million, MTS only in 2003 spent over USD 250 million on UMC development. According to estimates, the total stock of MTS investments in Ukraine amounts to USD 1.2 billion by the end of 2004. MTS actively co-operates with leading equipment suppliers (Alcatel and Siemens) to expand UMC GSM network, optimize existing infrastructure, and accelerate development of next-generation products and services. As of September 2004, UMC network covered over 80% of the country's territory and about 90% of the population. Having the status of the MTS subsidiary, UMC gets better access to foreign financial sources. Thus in 2004, UMC took over a USD 50 million-loan from ING BHF-Bank and Commerzbank for financing the purchase of GSM equipment from Siemens (BBC Monitoring, 2004).

However, despite certain success MTS faced some serious problems in Ukraine. They basically come from high level of political risk in the country and ideas of re-privatization. In case of UMC, the Ukrainian Prosecutor-General's Office (the PGO) in June 2004 claimed that the sale of Ukrtelecom share of the company to MTS was in breach of Ukraine's privatization laws, and therefore, announced re-privatization campaign. The initiators of the idea would like Ukrtelekom to regain 51% of UMC. In exchange, Ukraine would pay back to MTS the entire sum of money that it spent for the deal (over USD 170 million). At the same time, the Ukrainian government does not examine any options that would allow MTS to get back its investments on the UMC development.

MTS managed to prove that it did not break the law and to win the trial in the court. The company also claimed that it was a victim of internal political disputes connected with the presidential election (Economist Intelligence Unit, 2004). Nevertheless, the Ukrainian Prosecutor-General said he would take another attempt to give the company back to Ukrtelecom. In addition to that, the case could be put on agenda in connection with future plans to privatize Ukrtelecom. Since it sold its share to MTS, Ukrtelecom value dropped down. The Ukrainian authorities wanted to increase as much as possible an attractiveness of future privatization tender. Due to the presidential election, these plans were postponed and it is not clear yet when a new government comes back to the issue.

Ukrainian authorities also blame UMC for low level of quality services. According to them, the mobile operator while attracting more clients does not care much about sufficient technical

support. In particular, the company's subscribers suffered serious communication problems in Kyiv over August 31<sup>st</sup> – September 1<sup>st</sup>. This infringes interests of consumers and may be considered as violation of the competition law. The Antimonopoly Committee forced the company to take urgent measures threatening to take away its license. UMC announced it would compensate subscribers' losses. In addition to that it was actually forced to install five new switchboards to increase installed capacity and to avoid network congestion.

The Antimonopoly Committee also criticizes UMC for keeping prices too high, at USD 0.13-0.21 per minute (The Economist Intelligence Unit, 2004b). In turn, MTS argues that the arrival of MTS on the Ukrainian market was "a powerful jolt for its development: the level of penetration of cellular communications doubled. We are investing in the development of the country's telecommunications market and its infrastructure, which is beneficial both for the state and for consumers" (BBC Monitoring, 2004).

Despite the problems, MTS would like to stay at the Ukrainian market. It is going to pay extra attention to network development, to open new service centres (own and joint offices with the dealers), to plan intensive marketing campaigns.

### ***4.1.3. Uzbekistan***

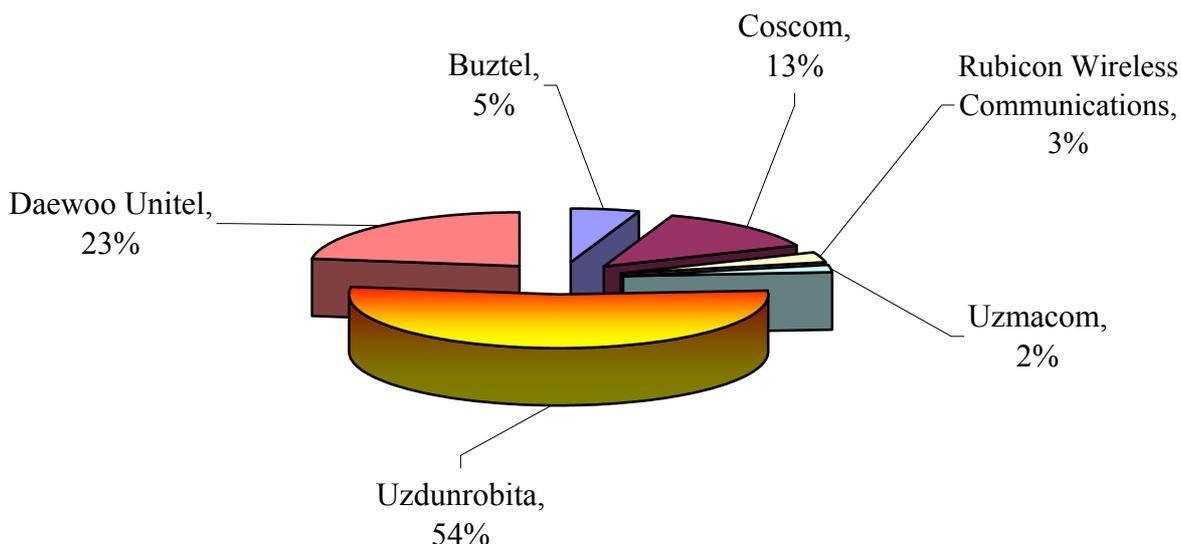
Uzbekistan is the third largest country in the CIS after Russia and Ukraine in terms of population. Almost 26 million inhabitants live there. The population density equals to over 50 persons per sq km. Similar to other CIS member-countries, Uzbekistan is a relatively fast developing market with GDP annual growth rate of about four per cent during last seven years. At the same time, national living standards still remain pretty low with GDP per capita equals to less than USD 400 in 2003.

Fixed telephone lines in Uzbekistan are considered by the bulk of experts to be obsolete, inadequate, and in serious need of modernization. The number of subscribers does not exceed two million people (less than 8% of population). As for mobile communication, the penetration rate currently does not exceed two per cent. At the same time Uzbek mobile market has started to grow really fast. For example, the number of mobile phone users in the country reached almost 470 000 in September of 2004 in comparison with 325 000 at the end of 2003. Under the

circumstances economic agents assess prospects for Uzbekistan mobile communications market as really promising, especially in long and medium run.

Six companies currently run their operations on the Uzbek mobile communications market. Two of them keep dominant positions. Namely they are – Uzdunrobota with 250 000 subscribers and Daewoo Unitel with over 100 000 subscribers. The others are far behind the leaders.

**Figure 8. Market share of Uzbekistan mobile service providers (September, 2004)**



*Source: European Mobile Communications Report, 2004*

**Daewoo Unitel**, launched in 1997, is the second largest GSM network operator in Uzbekistan with a market share of 23%. Its network covers major densely populated areas of the country. In autumn of 2004, Daewoo International sold out the company for close to USD 75 million to a consortium of Germanos SA (the largest telecom equipment company in Greece), EBRD, and Global Finance (Greek private equity and venture capital firm that manages the Black Sea Fund, in which the EBRD is an investor) (Russian telecom company..., 2004). Germanos SA decided to participate in this acquisition taking under consideration favorable prospects for the market under review as well as commitment to vertical integration strategy. On the other hand, having EBRD as one of the shareholder the Daewoo Unitel might have better access to financial resources. This would allow the company to develop and modernize its network. The activities under review should be mostly focused on expanding the geographic coverage and product range. The ultimate goal is to make mobile services more affordable in economic terms and hence to capture the lower income segment of the population.

MTS began its expansion towards Uzbekistan through the acquisition of **Uzdunrobota**, the leading mobile service company functioning in the country, which controlled approximately a half of the market. The deal immediately put MTS into the position of a leading player in the market. In the beginning of August 2004, MTS purchased three quarters of Uzdunrobota for some USD 120 million from two private companies. The agreement also included an option to acquire the remaining quarter for not less than USD 40 million. In this case MTS will be the only owner of the company. The deal requires the permission of national regulators both in Russia and Uzbekistan, as well as approval of MTS board of directors, before it can be completed. MTS plans to participate in further development of Uzdunrobota projects aimed to improve the quality of its services.

The acquisition of Uzdunrobota was an expensive one for MTS. Indeed, the company already paid almost USD 500 per each subscriber it got. At the moment it looks like an open question whether MTS manages to recoup its investments quickly enough and to gain sufficient experience for future market expansion towards other countries.

Like in Ukraine, Alfa Group (via Alfa-Telecom) decided to buy two mobile service providers in Uzbekistan. Thus, in December, 2004 it bought **Buztel** company from Indonesia based Bakrie Group. The company is licensed to provide mobile services in GSM 900 standard. In the beginning of 2005 the holding also purchased 74% of Uzmacom from Malaysian Superior Communications (the rest 26% belong to the state). The company operates in GSM 900/1800 standard all around the country. It seems that Alfa-Telecom concentrates resources in order to build a strong and competitive network in Uzbekistan. In contrast to MTS, Alfa-Telecom buys smaller companies and gradually works on their development. Analysts say that in the nearest future the control on the Uzbek assets may come to VimpelCom (Rosbalt, 2005b). Like in Ukraine, one could expect the competition of two leading Russian mobile service providers on Uzbek market.

#### ***4.1.4. Turkmenistan***

Turkmenistan became the target country of Russian telecom companies only recently. The population of Turkmenistan is not as large as in other CIS countries (5 million people). The population density is relatively low (10 people per sq km). National economy has been demonstrating the highest GDP growth in the CIS region in last several years (some 17% in

1999, 20% in 2002, 17% in 2003). In terms of GDP per capita, the country has the fourth highest rating in the CIS (over USD 1200 in 2003). The penetration of mobile communication services does not exceed one per cent – the lowest level in the CIS region. Analysts regarded Turkmenistan as a great potential market for telecommunications.

USA-based **American Barash Communication Technologies Inc. (BCTI)** by the beginning of 2005 was the only mobile communication company in Turkmenistan. BCTI owns the entire range of frequencies required to establish GSM and 3G networks: 900 MHz, 1800 Mhz, 1900 MHz and others. Yet another mobile communication license belongs to Ministry of Telecommunications of Turkmenistan. It is planning to launch its network in 2005.

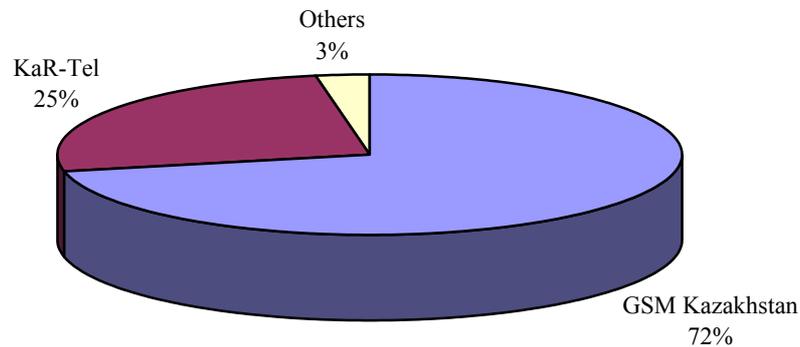
Similar to its experience in Uzbekistan, MTS decided to enter the Turkmen market by purchasing the leader. At the moment, the deal valued for USD 55 million is at the final stage, although MTS has not confirmed it yet. If the purchase takes place, it would be the highest per-subscriber price ever paid by a Russian mobile company for cellular assets. Despite of direct commercial considerations, experts treat the contract as a very important one from the political point of view. For the first time in the post-Soviet history, a Russian telecom company could get the position of the monopolist on the foreign market.

#### ***4.1.5. Kazakhstan***

The mobile penetration level in Kazakhstan slightly exceeds 13% that is much less than that in Russia. To-date the market is still in its infancy. That mainly results from vast territory of the country in combination with lack of adequate infrastructure. At the same time, that provides good growth opportunities. The number of mobile subscribers since 2000 increased more than 13-fold. Annual growth in 2004 slowed down in comparison with previous years, but 86% still looked impressive and attractive for newcomers.

Competition on the national market is high compared to that in Uzbekistan and Turkmenistan. General situation resembles the Ukrainian model. There are two obvious leaders (GSM-Kazakhstan and KaR-Tel) as well as two smaller companies.

**Figure 9. Market share of Kazakhstan mobile service providers (September, 2004)**



*Source: European Mobile Communications Report, 2004*

**GSM-Kazakhstan** (works with two trademarks K-cell and Active) today holds almost three quarters of the Kazakh telecom market. The total number of its subscribers amounts to over one million as of August 2004. The company has two main owners: 51% of its stock belongs to Dutch company Fintur Holdings B.V. (owned by Scandinavian TeliaSonera and Turkish Turkcell) and 49% are in the property of nationally-based Kazakhtelecom.

Kazakhstan's second largest mobile operator **KaR-Tel** (works with two trademarks K-Mobile and Excess) has approximately 600 000 registered subscribers at the end of August 2004, and its market share is about 25%. Initially, KaR-Tel was a Kazakh-Turkish joint venture but Kazakh side accused its two Turkish partners in non-observance of obligations and took their shares back through the court. In August 2004, Kazakh owners organized a tender for KaR-Tel. Eight companies participated in the tender, among them were Russian mobile operators MTS and VimpelCom. The latter won the tender and purchased whole KaR-Tel from the Kazakh parent company for USD 350 million and simultaneously took a burden of KaR-Tel's huge debt (Yevstigneyeva, 2004).

The price of the deal was pretty high, but VimpelCom perceives the Kazakh mobile market as very important for its international expansion, as it was the first foreign market for the company. VimpelCom had previously focused on the rapid growth of its network towards Russian regions. Moreover, buying a local operator may be the only path to international expansion in

Kazakhstan. Earlier in February 2004, VimpelCom tried and failed to win a tender for Kazakhstan's third GSM license. The aim of the company in Kazakhstan for the coming years is reportedly to increase mobile penetration in urban areas to 70% (more than a half of the Kazakh population lives in urban areas).

So far Kazakhstan is the only CIS market, where MTS has tried and failed to enter. On the other hand, relatively low penetration level and importance of Kazakhstan as a big and rapidly developing market is a challenge for the leader of Russian telecom. Deepening of economic integration between Russia and Kazakhstan may enhance the penetration of Russian companies to the neighbouring country, and many of them are corporate clients of MTS. That may create an additional incentive for the company to repeat its attempts to enter the Kazakh market.

#### ***4.1.6 Caucasian countries of the CIS.***

Armenia, Azerbaijan and Georgia are relatively small economies in terms of population (the smallest one – Armenia – has only three million inhabitants). All three of them also have low living standards (Georgia has a fifth lowest GDP per capita level in the CIS). Development of the telecom sector in these countries varies. For example, Armenia is an evident outsider among the countries under review in terms of subscriber base and penetration level. Both of them do not exceed five per cent, while Georgia with its 18.2% penetration is close to Belarus or Ukraine.

Azerbaijan might be perceived as rather promising target. However, its market is mostly closed and highly monopolized with just two dominating mobile operators. **Azercell Telecom** is a joint venture being in control of almost 70% of the national mobile communications market. The company, founded in 1996, belongs to the state (51%) and to a foreign investor Fintur Holding B.V. (49%). **Bakcell** was the first privatized mobile operator in Azerbaijan, which initially had been partly state owned, but later became fully private. Today this operator belongs to an Israel company GTIB-96. Bakcell holds 30% of the Azerbaijan telecom market.

State officials express doubt about indirectly revealed intentions of Russian companies (first of all MTS and Rostelecom) to enter the market. They argue that the Azerbaijan telecom market currently does not need a third operator due to drawbacks in the licensing system. Moreover, if such an opportunity arises, the state could look at more appealing bids than any of Russian telecom companies for the third operator (AzerPress, 2004).

Armenian market was for a long period monopolized, and the only operator was **ArmenTel**. It provided GSM 900 services since 1998. In December 1997, Greek telecom company OTE purchased 90% of ArmenTel stock for USD 142.5 million at an international tender. According to the agreement signed by the Armenian government, ArmenTel received a monopoly in the sector for 15 years. OTE invested USD 200 million in Armenian telecommunications during the first five years. On November 3, 2004 the Armenian government decided to make amendments to the license of telecommunication monopolist, according to which the company is deprived of the exclusive right for GSM services and mobile satellite communication. This monopoly had a negative impact on the overall development of mobile communication in the country. In the same month a second mobile operator, nationally-based **K-Telekom** started to operate. This recent developments gave a green light to foreign companies (Russian as well) interested to enter the Armenian market.

Georgia is a market with relatively high level of competition and openness (penetration level equals to 18%) and presence of national and foreign telecom companies (from the USA and Turkey). In general, this market has a relatively low growth potential. Being the poorest country among all three, Georgia at the same time keeps much lower economic growth rates than neighboring Azerbaijan and Armenia. Territorial conflicts (one in South Osetia and another one in Abkhazia) still split the republic. Attitudes towards Russian business in Georgia are not that positive as, for example in Armenia. That is one of the reasons why none of Russian telecom leaders have entered that market.

Presently there are three main mobile operators in Georgia. **Geocell**, the first GSM operator in Georgia was established in 1996 as a joint venture of Sakartvelos Telekom (2%), Georgian Electric Connections (GEC) with 12%, Turkcell (40%), and Celcom (46%). The company signed international roaming agreements with 200 operators in over 87 countries, including Russia. Coverage had reached more than 80% of the territory. Company **MagtiCom** was founded in 1997 by Georgian Magti Group with a 51% share and US operator Telcel Wireless with 49% of the stock. The company started operations in both GSM 1800 and GSM 900 standards in September 1999. Magticom began offering prepaid card services in July 2000 under the brand name MONO. **MegaCom**, an AMPS operator, was established by the American Company Schuman in 1994. The country's first cellular mobile network – a Digital Advanced Mobile Phone Service – was launched by MegaCom in 1994. The company expanded by acquiring of three GSM 900 networks (in 1996, 1997 and 2000). Despite the company's early presence at the market, it is now an outsider with just 6.1 thousand subscribers.

Meanwhile, in Georgia (as in Armenia) the market situation is currently changing. The Georgian government organises a telecom license tender in the beginning of 2005. Russian mobile operators, (all three leaders, as well as SMARTS) intend to participate in the tender.

#### ***4.1.7 The rest of the CIS countries***

Tajikistan and Kyrgyzstan are the most undeveloped countries of CIS in terms of GDP per capita (in 2003 it accounted USD 206.4 and USD 333.3 respectively). Moldova is ahead of Uzbekistan in this sense with USD 476.2, but far behind all other CIS member-states. All three have comparatively small population (Tajikistan is the largest with 6.3 million<sup>4</sup>). At the same time these countries have much in common with the others and generally belong to target markets potentially attractive for Russian telecom leaders. Under the circumstances one might argue that the companies sooner or later will try to enter them within the framework of their further internationalization efforts.

Tajikistan, the poorest among CIS countries, experienced the highest market growth rates in the alliance (almost 640% from September 2003 to September 2004). Tajikistan's telecommunication network is one of the least developed in the alliance. The mobile subscriber base remained at the same level for several years, and the market started to grow rapidly only recently. By September 2004 the total number of subscribers was about 95 thousand. That equals to 1.4% in terms of penetration rate.

Existing opportunities already attracted one leading Russian operator MegaFon, which entered the Tajik market in 2001 by acquiring 75% of local operator **TT Mobile**. Besides, there are three other telecom companies on the market. Taking into account that for MegaFon Tajikistan is the only foreign market one can argue that other Russian mobile operators may not concentrate on expanding to this country, at least in a short run.

Kyrgyzstan has been expanding and upgrading its telecommunication network since 1991. At the same time, much work remains to be done. The mobile market is still in its infancy. Nevertheless, low penetration rate (5%) presumes high growth potential. There are two mobile operators on the market (**BiTel** – 80% of the mobile market, operates GSM standard, the number of its subscribers approach 300 thousand, and **Katel**, which operates D-AMPS standard). But there is still enough space for the newcomers, and the current subscriber base growth is very

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<sup>4</sup> In 2003.

high. So, Kyrgyzstan market of mobile communication is pretty interesting for Russian companies. Experts suppose that VimpelCom and MegaFon might take certain efforts to enter it in the nearest future, and that is an obvious challenge for MTS.

In particular, it was announced that Alfa Group (strategic investor of VimpelCom) bought an option to purchase 100% of BiTel shares. At the same time, due to various disagreements with previous owner Bermudan foundation IPOC Russian company still cannot finalise the deal. At the beginning of 2005 the question remained unsolved and Alfa Group may take the case into British court.

Moldova with 15% penetration rate is far ahead of Kyrgyzstan and Tajikistan. Two companies dominate Moldova cellular market: **Voxtel** with 368 thousand subscribers and 56% of the market and **Moldcell** with 249 thousand subscribers and market share equal to 38%. Both mobile service providers operate GSM 900 standard. These companies were established with participation on foreign capital: France Telecom owns 53% of Voxtel while 77% of Moldcell belong to Fintur, a partnership between Turkcell and Sonera (Paul Budde Communication, 2002). In July, 2004 a new CDMA 800 licence was issued. It was granted to **InterDnestrCom**, the company that works exclusively in Dniester Moldavian republic.

Perspectives of Russian telecom companies in Moldova could be regarded as quite modest, at least in the short-run, due to the fact that large international players had already gained strong positions on the Moldavian market. High level of political instability may also influence the decision of Russian companies to invest into the country.

## **4.2. INDIA AS A NEW TARGET MARKET**

India happened to be the first non-CIS target destination for Russian telecom companies, MTS in particular. The country has been gradually transforming its economic base from agrarian to industrial and commercial. For many years after independence, Indian economic policy emphasized central planning with the government setting goals for, and closely regulating, private industry. In the late 1970s, the government began to reduce state control of the economy.

With its population of nearly 1100 million, India is the second largest country in the world. The population density is about 333 people per sq km. GDP growth varied from 4.6% in 2002 to

8.0% in 2003. At the same time, GDP per capita remains low. In 2003, it did not exceed USD 550. But in purchasing power parity equivalent it is five times larger. India's population is very polarized, hence in spite of low average incomes there exists a large middle class, - by some estimates it exceeds 100 million people. The attractions of doing business in India are its vast number of customers (so that even a modest improvement in living standards can lead to greatly increased sales). India like some of CIS countries has one of the lowest penetration level both in fixed and mobile phone services (4% and less than 3% correspondingly in the middle of 2004). That also indicates good opportunity for mobile sector development.

By the beginning of 1990s only state-owned companies were allowed to operate in telecom sector. Then the government realised that it does not have enough financial resources to fulfil the country's needs and achieve the nation's telecom targets. In 1992 private sector was invited to participate in the development of telecom sector, both mobile and fixed. After a competitive bidding process, licenses were awarded to 8 mobile operators in the four metropolitan cities (so called metros - Delhi, Mumbai, Kolkata & Chennai), 14 mobile operators in 18 state circles.

The Government admitted that the result of the privatisation has so far not been entirely satisfactory. While there has been a rapid growth of cellular mobile networks in the "metros" and states with currently over 1 million subscribers, most of the projects faced the problems. The main reason resulted from the fact that the actual revenues generated by these projects have been far short of the initial expectations and the operators were unable to arrange financing needed to maintain and complete their projects.

In March, 1999 the new National Telecom Policy (NTP) was announced. Among the objectives of the NTP 1999 were the following:

- Provide availability of affordable and effective communications for the citizens;
- Create a modern and efficient telecommunications infrastructure taking into account the convergence of IT, media, telecom and consumer electronics and thereby propel India into becoming an IT superpower;
- Protect the defence & security interests of the country;
- Enable Indian Telecom Companies to become truly global players.

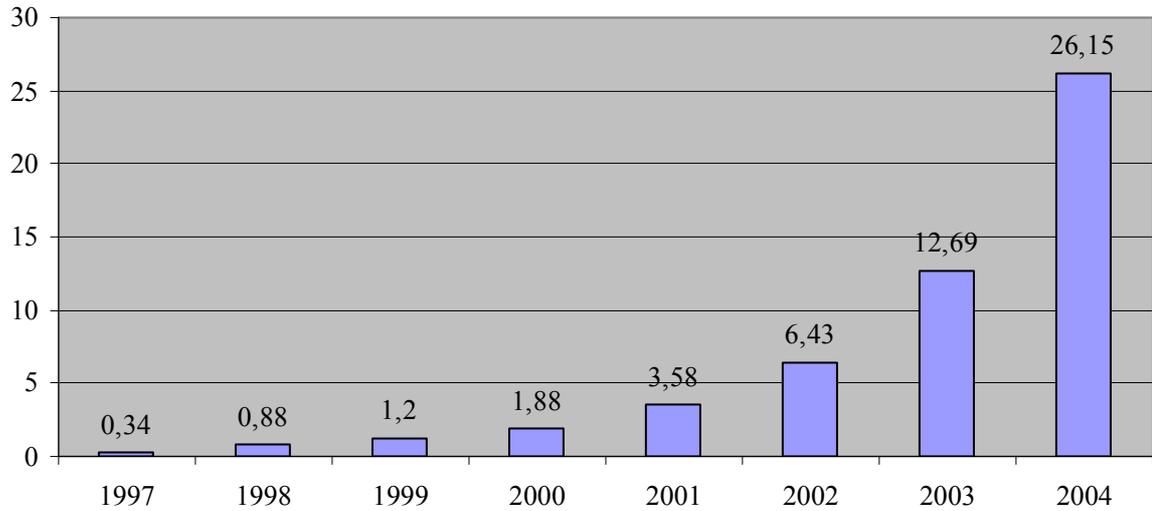
According to NTP 1999, mobile service providers shall be permitted to provide mobile telephony services including permission to carry its own long distance traffic within their service

area without seeking an additional licence. Such companies shall be free to provide, in their service area of operation, all types of mobile services including voice and non-voice messages, data services, etc., that meet the relevant International Telecommunication Union (ITU)/ Telecommunication Engineering Centre (TEC) standards. In order to increase competition, the allowed number of players in each region was exceeded from two to four mobile service providers.

Mobile service providers are granted separate licence, for each geographical circle (so called service circle). Licences are awarded for an initial period of twenty years and would be extendible by additional periods of ten years thereafter. Companies are eligible to obtain licences for any number of service circles. Mobile operators are required to pay a one time entry fee. Apart from it, the companies are also required to pay licence fee based on a revenue share. By the end of 2004 there were 78 licences owned by 20 companies for 23 service circles with a maximum of 4 licences in a service circle.

The Indian mobile service sector demonstrates rapid growth since the mid 1990s. The number of mobile service subscribers exceeded 26 million as on 31.3.2004 (Department of Telecommunication, 2004). According to Informa Telecoms & Media by January, 2005 the figure almost doubled and approached 50 million and it is far from the limit. Analysts expect to have more than 100 million customers in the sector by end 2005. Even modest forecasts on Indian mobile service development predict more than 50% growth in the sector.

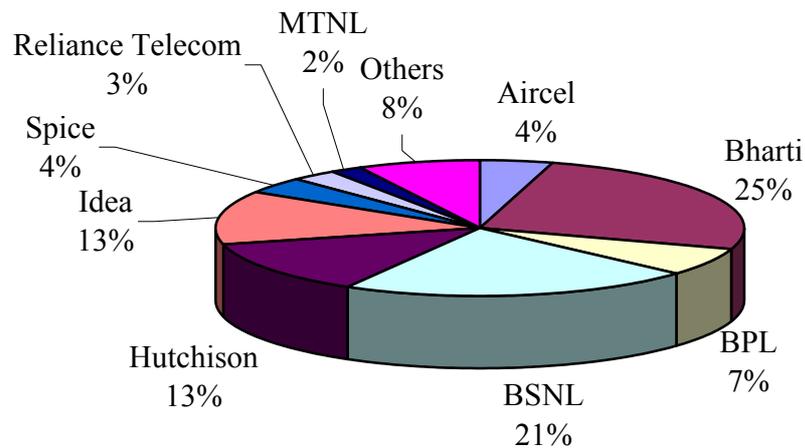
**Figure 10. Mobile Phone Subscribers in India, million people  
Year ending 31st March**



Source: *Department of Telecommunication (2004). Ministry of Communications & Information Technology. Government of India. Annual Report 2003/04, p.92*

Till quite recently national market was divided between relatively large number of the companies.

**Figure 11. Market share of India mobile service providers (February, 2004)**



Source: *Calculated from COAI, 2005*

**Bharti Tele-Ventures Limited (BTVL)** is India's largest non-government telecom company (28% of the shares are owned by Singapore Telecommunications Ltd.) and the largest provider of GSM mobile services (AirTel – Rajasthan network). It also provides fixed-line local access, and other network solutions. Through its subsidiaries BTVL has licences to provide GSM services in all telecom circles of the country. By the beginning of January, 2005 the number of mobile phone subscribers of the company was about 10 million people.

State-owned **Bharat Sanchar Nigam Ltd (BSNL)** is the largest telecom operator in India, providing basic fixed-line services nationwide, except for the cities of Mumbai and Delhi. BSNL lost its exclusive rights to local access and national telephony in 2001. To compensate for reduced revenues, it built a national GSM network and entered the mobile sector, becoming the country's second largest GSM operator. The company also owns licences in CDMA standard.

**Mahanagar Telephone Nigam Limited (MTNL)** was set up in 1986 by the Government of India in order to develop telecom services in India's key metros – Delhi and Mumbai. With the market opened to competition in 2001, MTNL has been facing rivalry for its share of the market and declining long-distance call rates. To diversify its revenue base, the company has expanded into mobile services in GSM and CDMA standards. Currently the government holds 56.25% stake in the company. At the moment with 13% of the country's telecom market, MTNL is one of Asia's largest telecom companies. It has licences to provide mobile services in Delhi including the peripheral towns of Gurgaon, Faridabad, Ghaziabad and Noida and in Mumbai including Kalyan. The company operates in GSM and CDMA standards, the number of mobile service subscribers reached.

**Hutchison Essar** was established in 1994 as a joint venture of Hong Kong based Hutchison Whampoa Limited (one of the largest companies listed on the Hong Kong Stock Exchange) with Max India Limited. In 1995 it became the first mobile service provider in the country. By the beginning of January, 2005 number of subscribers exceeds 7.1 million in the major regions – Orange in Mumbai and Hutch in Delhi, Karnataka, Andhra Pradesh, Chennai, Kolkata, Gujarat, Haryana, Rajasthan, Uttar Pradesh (E), Uttar Pradesh (W), Rest of Bengal and Punjab. It offers a wide range of telecom services, including fixed line services, internet services, broadband networks, mobile telephony, etc. The company operates in GSM standard and, in addition to that, got licences to provide G3 services.

**BPL Mobile** started its operations in 1995. At the moment it is presented in Mumbai, Maharashtra, Goa, Kerala, Tamil Nadu and Pondicherry. All in all, its network covers 209 cities. The number of subscribers is over 2 million.

**Idea Cellular** is a joint venture between Tata, Birla and US-based AT&T. It was set up in January, 2001 as a result of the merger of Tata Cellular and Birla AT&T Communications. It has presence in seven states: Maharashtra (excluding Mumbai), Goa, Gujarat, Andhra Pradesh, Madhya Pradesh, Chattisgarh, Uttar Pradesh (W), Haryana, Kerala and Delhi (inclusive of NCR). The company operates in GSM and CDMA standard.

Reliance Infocomm Ltd., a Reliance group company, is India's largest private telecom service provider with a subscriber base of over 10 million.

**Aircel Televentures Ltd (ATVL)** is the holding company of Aircel Ltd and Aircel Cellular Ltd owned by Sterling Infotech. With 1.65 million GSM service subscribers the group is the sixth largest mobile phone provider in the south of India. Even though the company owns licences for 12 circles, Aircel provides operates in two circles only (Chennai and Tamil Nadu).

At the moment Indian mobile service market experiences pretty large amount of M&A. It seems that the number of mobile service providers will decrease from a dozen to four or five companies. High level of competition and low tariffs force smaller operators either to close or to sell out to bigger players. A number of important takeovers and mergers that took place in recent years gave birth to three major players – Hutchison Telecom, Bharti Cellular, and the Birla-AT&T-Tata-BPL.

Current attempts of Russian companies to enter Indian market should be perceived in close connection with above-mentioned developments. In particular, AFK Sistema<sup>5</sup> signed a preliminary agreement to buy 49% of Aircel for \$450 million from its owner on December, 2004. According to the deal, the Russian company has to set up a subsidiary in India to acquire the stake. In addition to that the company will get licences to operate in seven new circles of Dishnet – Northeast, Assam, Bihar, Orissa, West Bengal, Jammu & Kashmir and Himachal Pradesh.

In the beginning of February, 2005 the Indian government allowed foreign investors to increase their share in India's telecom service providers from 49% up to 74% (Tolkacheva & Bhatnagar, 2005). A new rule gives foreign companies the opportunity to strengthen their positions in the

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<sup>5</sup> Even though MTS itself does not take a part in the deal, one could speculate that it will be in charge of it as a part of AFK Sistema holding.

country. This corresponds with the wish of AFK Sistema to have majority in all telecom companies under control. In compliance with the new regulation AFK Sistema will have the option to increase the stake at least up to 51%.

The deal seems to be quite advantageous for AFK Sistema. The acquisition cost per subscriber is estimated at USD 273. It is much less than in the CIS countries. At the same time one should bear in mind high level of risks and still low purchasing power of bulk of the country's population.

Currently it is too early to analyse possible outcomes of the purchase. The deal under review is non-binding. One of Aircel executives said the company was open to negotiations with other buyers if they offered a higher price. No final deal has been signed with AFK Sistema by beginning of February, 2005.

More than that, in order to come into force, the deal has to be approved both by Russian and Indian authorities. It might be not that easy. Thus Hutchison signed an agreement to buy Aircel on June, 2004 (Tolkacheva & Bhatnagar, 2005). The deal with Hutchison was never approved and afterwards Aircel started negotiations with AFK Sistema. At the same time, the chances of approval the deal between AFK Sistema and Aircel by Indian authorities are quite good. Under the agreement, AFK Sistema gets the shares in exchange for purchase of India's public debt to USSR.

Aircel is not the only target company for AFK Sistema. It is also in talks to buy out a part of stake in BPL Cellular, which operates in the Mumbai circle. In addition to that in May, 2004 Russian holding took part in a tender to buy 33% of Idea Cellular Ltd. It did not manage to win and Idea was sold to Singapore Technologies TeleMedia – Telecom Malaysia for USD 220 million.

At the moment the only deal that came into force between AFK Sistema and Indian company was an agreement with Sobha Renaissance Information Technology on a partnership in hi-tech solutions development. The deal was signed during the visit of Russian president Putin to India on December, 2004.

Telecom market entry via joint venture creation seems to be the best option for AFK Sistema in India due to the following reasons:

- complicated business environment, lack of knowledge about peculiarities of doing business in India, the company to certain extent may rely on/ and learn a lot from Indian partner;

- entirely different business culture (from this point of view it's much easier for MTS to operate in former USSR republics);
- there is no need to spend time and money of establishing new additional network;
- via a purchase Russian company eliminates at least one potential competitor.

Acquisition of medium-sized company in India (in contrast to CIS) may provide AFK Sistema with the following benefits:

- the deal requires less amount of financial resources;
- it is much easier to come to an agreement with the smaller company;
- AFK Sistema may use this investment as a base for future market penetration;
- in the case the company does not succeed the losses would be less.

## 5. CONCLUSIONS

Russian mobile market has been experiencing fast growth during last several years. At the moment three leading mobile service providers divide among each other almost 90% of the market. Competition between telecom companies inside Russia gets stronger and they have to look for new growth opportunities. The outward internationalization strategy could be regarded as the best option for their development.

The mobile service markets of the former USSR countries (except from the Baltic States) are potentially quite attractive for Russian telecom companies due to various reasons. First of all, the competition level in the CIS is not as high as in Russia. Second, those markets demonstrate an impressive growth potential. Third, Russian companies try to pass ahead leading Western telecom services providers and consolidate their grip on the new territories.

In each CIS country where Russian companies operate one could observe sustainable mobile market growth. It could be explained by two main reasons: an urgent need for modern communication tools, on the one hand, and aggressive marketing campaigns of mobile service providers, on the other hand.

Entry modes for Russian companies were predetermined by technological and regulatory considerations. As for target markets they largely resulted from historical and cultural traditions, common infrastructure network, similar business practices, and development of reintegration process within the framework of the CIS. It seems that those companies will use their knowledge and existing positions as the platform for future expansion to other CIS countries.

Due to various types of similarities between Russia and its neighbours Russian telecom companies may understand market environment in the region better than their Western counterparts, and therefore, use this understanding as its competitive advantage. At the same time main threats would most probably come not from national telecom service suppliers, but from Western telecom MNCs with huge financial recourses.

Regarding regulatory issues, it is necessary to mention that without a political will of the national authorities Russian companies could not get access to their privatization processes. In addition to that, due to high level of monopolization in most of the countries under review in order to be successful the companies should establish good relationship with local anti-monopoly agencies.

Since 2001 Russian leading mobile phone companies started their outward internationalization by expanding to the neighbouring CIS countries. The first were MegaFon and MTS in 2001, VimpelCom “joined the club” in 2004. The most attractive markets of those companies were Ukraine, Belarus, Tajikistan, Kazakhstan, Turkmenistan and Uzbekistan.

India might become a new promising target destination for the Russian telecom companies. Despite low GDP per capita and complicated and strict regulation of the telecom market in the country, rapid growth rate of the sector under review gives hope that operations of Russian mobile operators would be successful. India could also be used as a platform for future expansion to some other countries of the region.

All in all, internationalisation of Russian telecom companies might be seen as sign of their maturity.

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