

When a New Licensing Regime for Mobile Operators in Syria?

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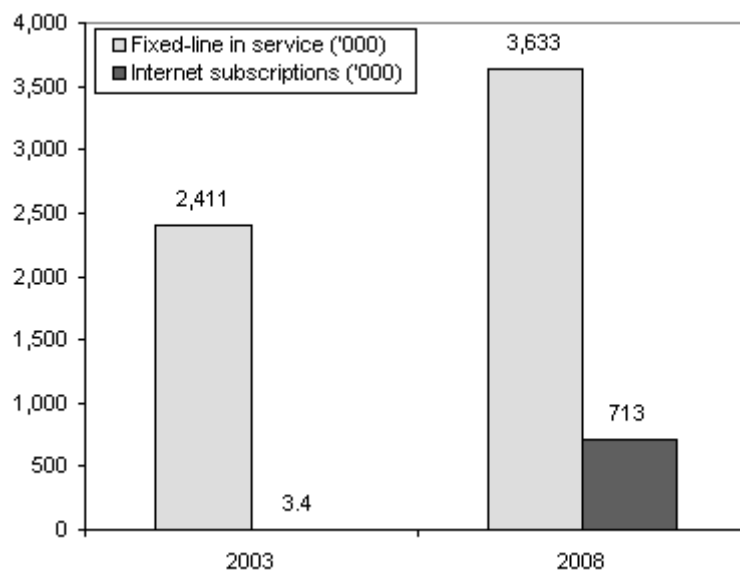
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Introduction - It has been a long time since Syria had to unveil a very long-awaited new telecommunications law, aimed at creating an independent regulator and a new licensing regime for mobile operators in the country. In addition to this, it is more than one year since the Syrian government outlined the idea of licensing a third mobile operator by the end of 2009 or the beginning of 2010. After all these months, nothing happened and at the moment of our writing (June 2010) there are not many updated information available through the Syrian media in relations to the development of a new telecoms law that is instead of crucial importance for the future economic development of Syria. On the contrary, bordering Jordan is very committed in the process of rewriting the country's telecoms law and perfectly understood the importance of the ICT sector for the economic growth of Jordan. All the interested actors seem – at least publicly – to agree that the mentioned steps should be implemented as soon as possible, but then nothing ever happens. Probably, the reason for not preceding is mainly rooted on the government side of the equation, but this could really impede the future progress of Syria.

Brief Overview of the Syrian Fixed Telecommunications and Broadband Sectors - Syria has currently the most regulated telecoms sector in the Middle East and it is also one of the least developed. It is true that year-over-year growth for 2009 was impressive at around 38% of overall penetration (September 2009) according to Mobile World Database (some other stats affirm that the rate is lower) but the average for all the MENA countries is around 75.6% (Syria ranks 15th out of 20 countries surveyed).

STE Achieves Continuing Growth

Fixed-Line And Internet Growth From 2003-2008



Source: ITU

This means that this country has an interesting potential growth also considering that there is a young and growing population (2.4% annual growth rate and only 40% of the population above the age of 65). All this is true, but regulations have necessarily to be improved in order to attract possible investors. Currently, the state-owned Syrian Telecommunications Establishment (STE also known as Syria Telecom) has the monopoly of the of the fixed-line service.

In 2002, the EU started to support the STE with a grant for a Telecom Sector Support Program (TSSP). The final goal was to support policies of economic development, reform of the public sector and improvement of the private sector with a specific attention given to telecom infrastructure and modern communication services. The TSSP (for a four-year period) with a budget of €10 billion was specifically trying to activate:

- A) Improved framework conditions and internal reform of the national telecom operator STE, and market regulations favourable to increased private participation in new telecom services;
- B) Technological and managerial modernization of STE, aiming at a competitive position in regional telecom markets;
- C) Strengthened institutional, managerial and financial autonomy and self-reliability of STE, aiming at a competitive position on the national market in conventional and new telecom-services;
- D) Improved and differentiated services to the public, elimination of capacity constraints in a growing telecom market. For this purpose, a number of targets have been adopted for the program concerning technical, managerial and financial indicators of STE, in order to provide clear orientations for project activities and benchmarks for progress evaluation.

The Strategy Paper 2007-2013 “Syrian Arab Republic” published under the European Neighbourhood and Partnership Instrument (ENPI) explains that the TSSP produced a restructuring plan for Syrian Telecom the “will pave the way for its corporatization and for the creation of an independent regulator in the telecommunications sector” and that “the EIB (European Investment Bank) provided €100 million to expand the telecom network in rural areas” (see: ec.europa.eu/world/enp/pdf/country/enpi_csp_nip_syria_en.pdf). It is a matter of fact, that also from the EU side there are not many easily available information in relation to the TSSP.

Following a five year plan (2008-2013) STE is now using \$1.5bn trying to cover with its improved network the whole country (universal fixed-lines) by the end of 2013, adding 920,000 lines to its existing network. The target could be not very realistic and the plan seems now to be put on hold given the world economic turmoil of the last two years. This plan is based on contracts signed with MNCs, such as Ericsson and Siemens. All this said, it is certainly true that Syria in the last years progressed consistently in extending the reach of its communication services. At the end of 2009, the state-owned fixed-line incumbent had 3.7 million of fixed lines. The persistent problem is that STE has a complete monopoly in relations to fixed-line services, meaning that there is no competition. Its financial results improved steadily in the last years thanks to its increased subscriber base that is linked not to the fact of quality improvements but to the inexistence of competition. In addition, customers still experience lengthy lags for the installation of landlines.

STE is also the public body that is investing – although in a very limited manner – in connecting Syria internationally through the UGARIT submarine cable. This 239km cable infrastructure started to operate in 1995 with a defined capacity of 622Mb/s. In November

2008, the STE together with the Cypriot Communications Authority (CYTA) signed a new document aimed at expanding the cable while increasing the internet capacity. At that time the two countries also decided to consider some feasibility studies to deploy a second cable in the sea. The Syrian government is also in talks with Jordan, Turkey, Cyprus and Iraq about the possibility of running a submarine fiber optic cable between the five countries. In 2009, the Syrian Minister of Communication and Technology, Imad Sabouni said: "one project underway is to try to find a link between operators in the Red Sea and those in the Mediterranean to benefit Syria and all the region." Sabouni added that the government would contribute with \$2bn funds put aside for the country's internet and phone network.

Internet penetration in Syria is very low and obviously broadband penetration is very reduced, with 50,000 broadband ports in H1 2009 (0.025% in 2008 according to ITU). In the same time, the government applies a strict and enforced censorship with many sites like Facebook, YouTube, Amazon, blogs and websites critical of the Syrian government that are all blocked. In some internet points (especially in the old city where the majority of users are tourists) it is possible that the manager unblock the restrictions but this is not something to take for granted. Also for skype there are different policies in the various internet centers (no skype at all, skype to a specified landline or mobile number and both skype-to-skype with skype to a specified landline or mobile number). As a matter of fact, it is much easier to get information about Syria in English living out of Syria than staying there. Broadband services are still expensive and it is not trouble-free to subscribe an ADSL subscription. Notwithstanding all these internet restrictions, there are no limitations at all on receiving DTH satellite TV channels. The majority of the populace normally link the dishes to Arabsat and Nilesat. The third choice sometimes is Hotbird.

History of Telecom Mobile Services in Syria – Nine years ago, in 2001, the Syrian government decided to award the first 15-year build, operate and transfer (BOT) GSM license to two operators of existing pilot projects. The first operator was Syriatel that at that time was a joint-venture 25% owned by the Egyptian Orascom Telecom Holding (OT) and 75% held by different Syrian investors (Drex). The second BOT license was awarded to a Lebanese-Syrian joint-venture called Investcom, competing against Turkish mobile operator Telsim. Investcom at that time was a branch of the Lebanese group Mikati, but in 2006 it merged with MTN South Africa and it created one of the biggest telecom groups in the emerging market of Africa and Middle East. It should be noted that both Investcom and Syriatel during the year before the awards (February 2001) were running some experimental mobile phone networks in Syria. The two companies poured in around \$31 million for these networks based in Damascus, Aleppo and Latakia. The pilot projects were due to be run for just one year. Mobile operations started in Syria in April 2001, although with some difficulties. In fact, demand for mobile services was below expectations given the high subscription costs. The result was that after six months the authorities were forced to drop costs by two thirds. The BOT license needed an initial payment of frequency fees of \$20 million for the GSM 900 Mhz network with an additional \$15 million to permit the operator to use the GSM 1800 Mhz frequency bands. The BOT contracts were also defining a revenue sharing agreement according to which the companies were bound to pay royalties for 30% of revenues for the first three years, moving to 40% for the second three-year period and then paying 50% of revenues from the seventh year of the BOT contract on. The companies also pay some protection fees.

At that time, Orascom was planning to have more than 850,000 users by 2016 when the BOT contract would have expired. Honestly, it was a very conservative estimate. Things changed abruptly for Orascom in the following months and then in June 2003 Orascom completed a transaction aimed at getting rid of its stake in Syriatel. In fact, Orascom

wanted to settle a legal dispute with its local shareholder Drex Technologies (owner of 75% of Syriatel) and the motive, according to Orascom allegations, was that Drex was using its strong political connections to take complete control of Syriatel at the expenses of Orascom. The settlement was able to solve all legal disputes in both international and Syrian jurisdictions. Since 2003, Orascom does not have any share in Syriatel and to settle the transaction according to unconfirmed sources was compensated for all the previously incurred expenses and loans. For some years after getting out from the investment Orascom continued to provide management expertise to Syriatel on an external contract basis.

Mobile Services in Syria Today - Syria has in all the MENA region between the highest tariffs and also one of the lowest mobile penetration rate (42% sim card penetration in June 2009). Mobile services are provided in Syria by two private operators – it is at the moment a duopoly- SyriaTel (55% of the market) and MTN Syria (45% of the market). The first one is Syria-owned while the latter belongs to the South Africa-owned MTN (it is a subsidiary of MTN South Africa). The two companies are often not far off even and operate through Build-Own-Transfer (BTO) contracts, normally used across industries in initial stages of development. Under these BTO contracts the two companies have to build the country's GSM technology and provide mobile and internet services before transferring everything to the Syrian government after 15 years. The rigid BTO scheme has been in place in Syria since 2002, but both companies would like to convert these BOT contracts into regular mobile operator licenses. One reason is surely the fact that after some years Syriatel and MTN have to pay very high royalties meaning 50% of revenues to the Syrian government together with a 20% charge to cover the cost of the infrastructure.

Another reason for changing from BTO license to a simple license is that although the companies enjoy a consolidated market, the BOT scheme is absolutely a big hurdle for competitive behaviour, especially in the area of tariff flexibility and promotions. Summing up, Syriatel and MTN claim that given all the cost and taxes they have there are no resources for investments targeted at adding further capacity and service upgrades. The result is that the two companies Syriatel and MTN Syria charge the same amount for calls and messages, plus they provide exactly the identical services with a perfect coordination so that it does not exist also in the mobile sector (like for landlines) any kind of competition. The only difference with fixed-line services, where there is monopoly (STE), is on papers because with mobile services there is a duopoly acting as monopoly.

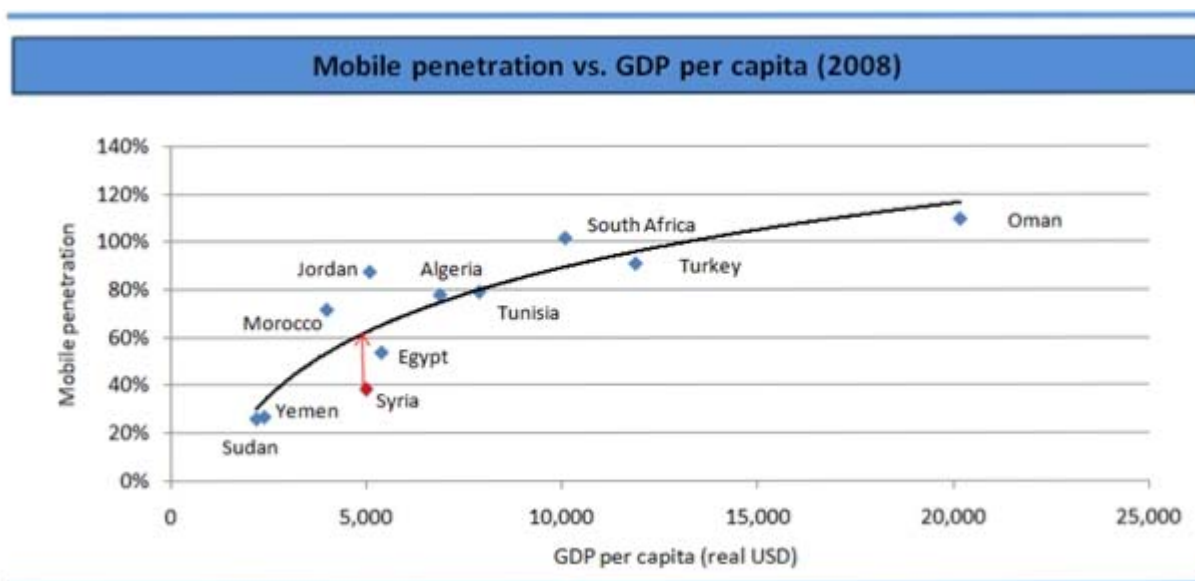
Syria has a population of around 20m and today two operators are considered inadequate. As it was pointed out above the country had been taking into consideration to add an additional third mobile operator since some years. Foreign telecom companies like UAE's Etisalat, Kuwait's Zain, Qatar's Q-Tel and Turkey's Turkcell have always been considered as potentially interested into joining the Syrian market. Between them in particular a strong attention have been expressed by Etisalat and Zain. According to Business Monitor International, a consultancy, the latter could be "interested in investing in Syria's mobile market, either through taking a stake in an existing operator or by acquiring a new operating license".

Acquiring a new operating license could be easier for Zain than investing in an existing operator. In fact, Syriatel was blacklisted by the US Dept. of the Treasury in 2008 and the reason was a presumed link of the telecom company with the Syrian government. This political hurdle was bypassed in April 2009 when Zain tried to buy a stake in Syriatel although it did not come to a success. Things could be easier now with MTN Syria whose 75% is owned by MTN South Africa. In fact, before selling for \$10.7 billion in the first days

of June 2010 all its African assets (Zain Africa BV, operating in 15 African countries) to Bharti Airtel Limited, an Indian telecom company, Zain was a business rival with MTN in Africa and buying a majority stake in MTN Syria would have never been approved by the Syrian regulations. Now things could be different. After the deal was concluded, Zain Group's CEO, Mr. Nabeel Bin Salamah said: "Zain stands at the threshold of a new era, one that will allow the company to focus on its highly cash generative Middle Eastern operations, investing in new growth opportunities in our exiting markets." Also Mr. Anas al-Khani, corporate affairs manager at MTN Syria, thinks that a regional company is best place in order to take up the license, but he hints at the fact that also "companies such as Orange, which operates in Jordan, France's Telecom and Vodafone have reason to be interested."

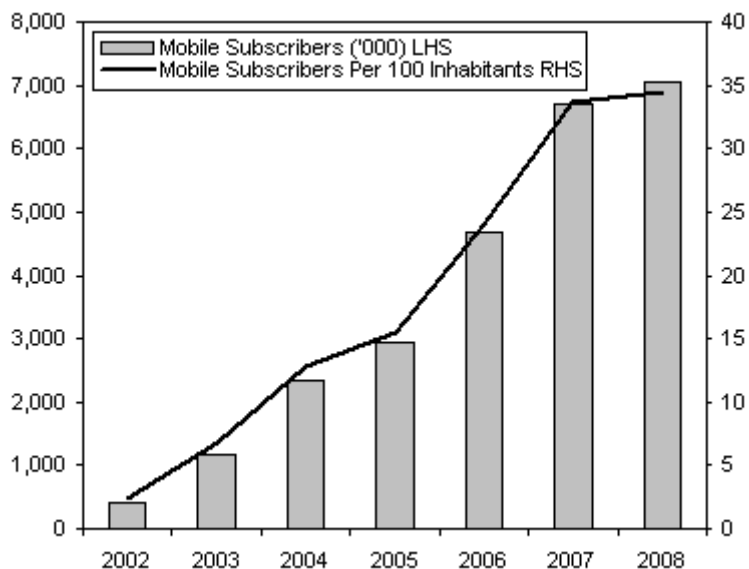
Commentators affirm that if a third operator were to enter the market, this time it would be under a license agreement and not anymore according to a BOT contract. But such an occurrence would spark strong protests from the side of the current incumbents. On the one hand, it would not be possible to have a playing field where out of three actors one is working through a license and two with a BTO contract. On the other hand, it is not conceivable to have a new entrant – especially a foreign company - that could easily accept to be subject to the same price controls as its competitors For this reason, it is understandable that if the new Syrian telecoms law is ever released it will necessarily change the whole telecoms panorama into a license-driven playing field.

The fact that in Syria in the mobile arena there is no competition bring with it the fact that there are some of the highest tariffs in the whole region. The mobile services are disproportionately expensive notwithstanding the introduction of prepaid cards in 2003. With the average Syrian salary around \$200, mobile services are available up to now for just an elite. A 42% mobile penetration exactly one year ago (June 2009) is low and the comparison with some of Syria's regional peers - using the two variables mobile penetration and current GDP - well exemplifies the scarce mobile penetration (see the graph below). There are now in Syria at least 4 million of untapped potential new subscribers. In may 2009, mobile phone users in Syria staged a one-day boycott of mobile services. This protest was decided in order to complain with reference to the high tariffs charged by the two operators Syriatel and MTN Syria.



Source: CIA World Factbook, Onda Analytics, operator data

Clearly, a one-day boycott was not a very powerful tool to have a significant dent in the profits of the two telecoms, but it was at least a signal of problem. According to Mr. Josep Maria Moya of Delta Partners, a consultancy, mobile users were probably angry at – in addition to the high tariffs – the restrictive validity of top-up cards. In fact, until last year customers buying the SYP150 (\$3.25) card had only seven days in order to use the credit before disconnection (expiration). In other words, this system forced customers to spend at least SYP600 every month. These fares are with no doubt too high for Syrians. This restriction had been partially lifted with an expiration time of two weeks. Honestly, it is still a powerful constraint.



Syria Mobile Market Growth – Source ITU

In public declaration released in the last months both MTN Syria and SyriaTel expressed the point that they would welcome a new competitor for mobile services in the Syrian market and they are already partially preparing for transforming their not well competitive companies into much more efficient firms. They understand that the present tariff have already reached the so-called saturation point. In other words with current prices a certain part of the Syrian population will never buy mobile services. For example: MTN’s average revenue per user for the first quarter of 2009 was \$17 while Kuwait’s Zain was \$52 and Qatar’s Q-Tel was \$44, although obviously in this countries per capita GDP is much higher and the offered telecom services of much better quality. Instead, should a license regime be implemented all the actors could have more flexibility, be more competitive and reduce the prices for consumers. According to Ismail Jaroudi, MTN’s CEO, “While we have accomplished a lot over the past few years within the boundaries of the BOT, we have now reached a point where we are stuck, and growth is not what it should be without the ability to lower tariffs. Overall, a new telecoms law that can formalize the sector and define the scope of the operators will have a great impact on mobile growth and the company at large.” Very honestly, if the new telecoms law is not going to change the BOT contracts there is absolutely zero incentive for Syriatel and MTN to invest resources in their networks or in their customer base when – given the BTO contracts – they can be obliged to hand over all their operations to the government. With no clear investment rules not many private companies are eager to invest with this trembling legal environment.

In general, many times new entrant strategies in the telecommunications sector – especially in developing countries - at the beginning rely on price competition that could be achieved either through direct decreases in tariffs or other indirect measures such as per-

second billing or increased pre-paid expiry periods. In a country like Syria, where at the moment there is no real competition, a new entrant is mandatorily obliged to act at a different level. In such a case a mobile network operator (MNO) will look for different key factors in order to differentiate itself from the competitors companies. These key factors could be a strong existing brand or an increased range of service provision. Between the latter one of these could be mobile broadband that could reap the benefit from the fact that Syria does not have relevant fixed broadband services.

Nazim Bahsas, general manager with the STE, in 2009 said: "fulfilling the regulatory role is not our core business and consumes more than 30% of our management time, detracting from our ability to focus on and dedicate resources to the operational side of our business". And then he added: "Looking at global trends, in nearly every market where a separate regulator was established, tremendous progress was achieved for the sector as a whole, so the new telecoms law is a must for the country."

Last but not least, the third eventual mobile license - as Minister Sabouni pointed out last year - "is one of the last mobile licenses to be auctioned in the region" and the Syrian government is counting on this in order to raise a critical amount of money.

REGIONAL MOBILE LICENCES

Tunisia: Preliminary contract awarded to the consortium of France Telecom and Divona/Orange for SYP 9,016bn (USD 196bn) in June 2009.

Bahrain: Saudi Telecoms Company paid SYP 10.6bn (USD 230m) in January 2009.

Iran: Tameen Telecom paid SYP 18.4bn (USD 399m) in December 2008.

Egypt: Etisalat paid SYP 134.8bn (USD 2.93bn) in July 2006.

Yemen: HiTS Unitel paid SYP 6.9bn (USD 149m) in May 2005.

Sources: Telegeography and Total Telecom

A New Telecommunications Law? – In February 2010, a press release by Syrian Telecom and Sofrecom, a consultancy, explained that the partnership STE/Sofrecom would modernize the network of Syrian Telecom transforming it into a "Next Generation Network". In addition to this, it was said that the objectives of the new telecoms law, under study, were to open the market, to augment the penetration of telecoms services and to propose to Syrians quality telecommunications services with reference to broadband and mobile communications. In other words, this press release was in particular giving info related to the steps necessary to build up a network infrastructure able to deliver broadband, data and multimedia services in Syria. To reach this target was identified Sofrecom as an important consulting body, advising Syrian Telecom for the main steps of the project for the following two years (Step 1: Audit & Description of the current network; step 2: Demand analysis & Definition of STE's target network; step 3 Proposition of different migration scenarios & recommendation of the optimum scenario to migrate to NGN; step 4: Follow up of the Migration Program) and were identified positive benefits for STE such as lower Opex and Capex and the creation of a revenue stream in a much more competitive environment. Mr. Bahsas was enthusiastically affirming that "the migration of our network to NGN is a must of our strategy. Indeed the NGN network will enable Syrian Telecom to deliver compelling services such as Video On Demand, Broadband internet and Voice over a single line. Our customers are hungry for broadband internet and value added services and Syrian Telecom shall meet their expectations. Sofrecom will help us to deliver enhanced services supported on a cost-effective and efficient NGN network." In other

words, all the actors – STE, Syria Tel, MTN Syria, Syrian government, foreign telecom companies and Syrian consumers – agree on the fact that a new telecoms law should be developed and following this step the mobile sector should be reformed with the transformation of the two BTO licenses into normal licenses and the auction of a third Syrian mobile license. All these actors and stakeholders agree but nothing is really happening. Once in a while there are some announcements, some press releases but then no concrete decision is ever taken and this could have very bad comebacks for the future economic development of Syria.

Conclusions - With no doubt Syria is experiencing a strong decline in its oil revenues over the last few years. This decline could push the Syrian government to invest in different sectors like the ICT that could be useful in improving the economic progress of Syria transversally through different economic sectors. Improving the competition in mobile telecommunications, providing one additional license and reframing the telecoms law, loosening the related regulations, could have very beneficial effects for the economic advance of Syria. All the interested actors seem – at least publicly – to agree that the mentioned steps should be implemented as soon as possible, but then nothing ever happens. Probably, the reason for not preceding is mainly rooted on the government side of the equation, but with no doubt not acting could really impede the future progress of Syria, a country already with a relevant development gap in comparison with bordering countries like Lebanon and Jordan. Countries that are fully aware of the powerful importance of the overall ICT sector and that have already implemented important actions.