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Safaricom Plc

“Is Safaricom losing its grip?”

Part 6: M-Pesa - “Mobmoney no problems”

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Executive Summary

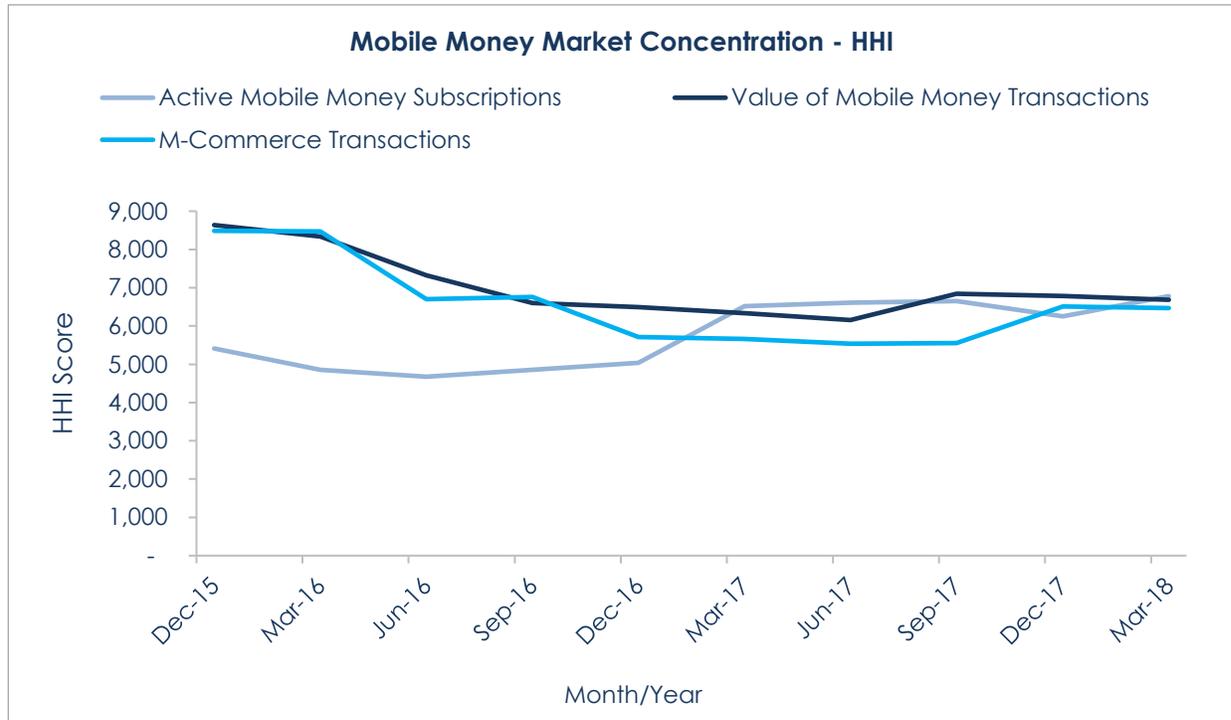
- **M-Pesa - “Mobmoney no problems”** is the 6th and final part of our 6 part series report titled **“Is Safaricom losing its grip?”**
- In the 1st part - **“Pricing Power Explained”** we explained the concept of “pricing power” which we defined as the ability of a company to raise prices over time without reducing demand for its products.
- We used the Herfindahl Hirschman Index (HHI) theoretical framework to determine the each business line's market concentration levels and mentioned in brief the services in which Safaricom has or does not have pricing power.
- The report begins with an analysis of the mobile money subscription, transfer and payment business concentration levels concluding that the mobile money market is highly concentrated.
- We then give a brief explanation of the reasons behind M-Pesa's market positioning with its huge agent network, multiple users and differentiated pricing amongst the reasons mentioned.
- We then conclude that M-Pesa holds pricing power and provide a timeline of historical price adjustments and market share trends.
- **M-Pesa holds considerable pricing power in both money transfer and payment services but in the latter we observe a growing competitive threat especially from Equitel that could erode its pricing power in the long-term.**
- Regulation is identified as a threat to M-Pesa's market positioning and we briefly mention some proposals made by Analysys Mason to the Communications Authority (CA).
- On service revenues, we do not see a significant threat in the short and medium term and forecast M-Pesa as the biggest revenue earner for the company in the next 3-5 years.

“Is Safaricom losing its grip?”	Report Title
Part 1	“Pricing Power Explained”
Part 2	Voice Calls - “Dialing the Wrong Number”
Part 3	SMS - “No one's texting”
Part 4	Mobile Data - “Losing its byte”
Part 5	Fixed Data - “The New Growth Frontier”
Part 6	M-Pesa - “Mobmoney no problems”

M-Pesa - The mobile money transfer & payment service

- Our analysis takes into consideration M-Pesa as both a money transfer and payment service.
- The HHI Index below indicates that the mobile money market in Kenya is highly concentrated with Safaricom the leader in active mobile money subscriptions as well as in both the mobile money transfer and payment business.

Fig.1: Mobile money business is highly concentrated



Source: Communications Authority of Kenya (CA), Sterling Research

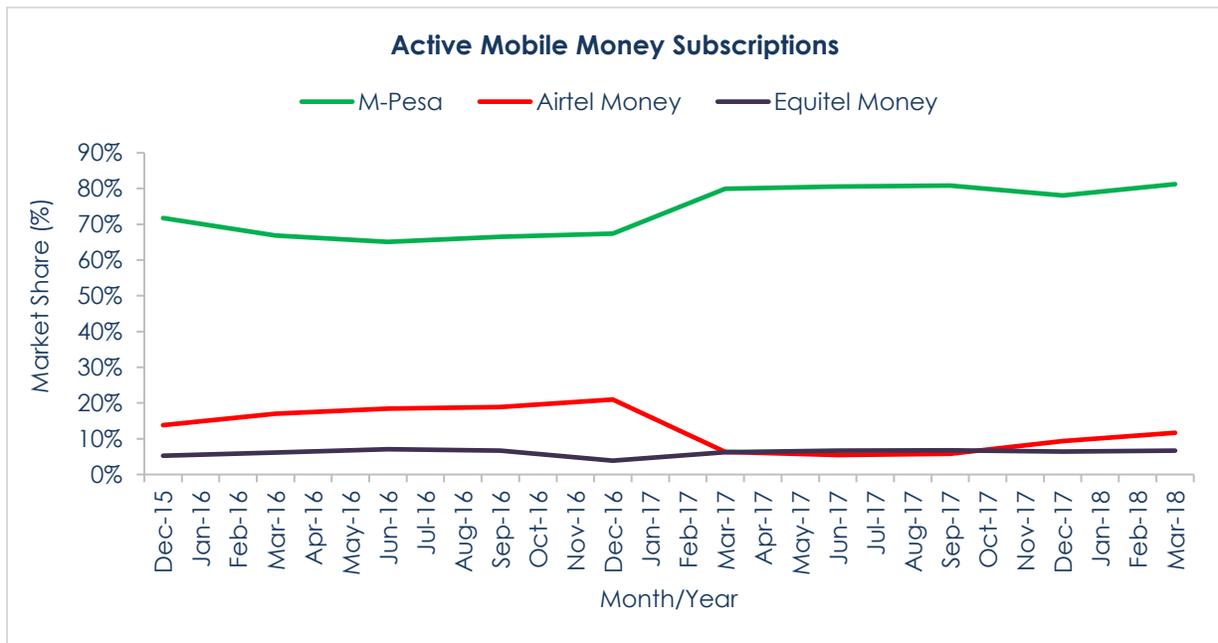
*Mobile Money Transfer Transactions-Sending (P2P) and Withdrawals

*Mobile Commerce Transactions- C2B, B2C, B2B, C2G, G2C

- According to the Communications Authority (CA), M-Pesa accounts for 81.2% of total mobile money subscribers, 79.1% of total value of mobile money transactions and 77.2% of total mobile commerce transactions (March 2018).
- M-Pesa continues to hold a high market share in all three metrics in spite of comparatively high transaction fees.
- M-Pesa is the preferred money transfer and payment system for the following reasons;
 - 1) **Huge agency network** - 156,726 agents (September 2018) across the country providing easy access and convenience has helped build customer loyalty.
 - 2) **Multiple uses** - M-Pesa is a mobile money transaction service allowing customers to deposit, transfer and withdraw money or pay for goods and services (Lipa Na M-Pesa).

- 3) **Differentiated pricing** - Different charges are levied on registered and non-registered customers and therefore encourages subscription to the service. M-Pesa also waives charges for single transaction up to KES.100 as well as Lipa Na M-Pesa transactions of up to KES.200.
- 4) **Strategic Business Partnerships** - Value added business partnerships such as M-Shwari, KCB M-Pesa and other services encourage customer loyalty.
- 5) **Better merchant network** - Safaricom's high market share makes it easier for the company to recruit and retain merchants who accept payments via M-Pesa. As at March 2018, the number of active Lipa Na M-Pesa merchants stood at 101,000.
- 6) **Refusal to allow agent interoperability** - Currently Airtel Money and T-Kash customers are unable to withdraw funds from Safaricom's M-Pesa agents and vice-versa even as interoperability facilitates smooth flow of funds across networks.

Fig.2: Safaricom has a 81% share of the total mobile money subscribers



Source: Communications Authority of Kenya (CA)

M-Pesa is the dominant force in mobile money transfers but faces competitive threats in mobile payments

- Safaricom's share of the mobile money transaction business declined from 92.8% in December 2015 to 74.2% in June 2017.
- We observe recovery to 80.1% in September 2017 and relative stability since then to 79% levels as at March 2018.
- We hold the opinion that **Safaricom holds pricing power in the money transfer business** and this view is supported by the following:

- 1) **February 2013** - Kenya government announce a new 10% excise duty tax on transaction fees for all money transfer services provided by cellular phone providers, banks, money transfer agencies and other financial service providers.

Safaricom responded by increasing tariffs for transactions above KES. 101 by 10% while those below KES.100 remained unchanged. Airtel and Yu Cash increased withdrawal charges maintaining no charge for sending cash. In spite of this, M-Pesa market share increased by 1% during the period ending March 2014 to 72%.

- 2) **August 2014** - Safaricom reduced M-Pesa charges for P2P transactions by 67% on transfers ranging from KES.10-KES.1,500. Charges for sending transfers exceeding KES.1,501 set at an average of 0.8% of the transaction value.

The revision we believe was aimed to counter competition from Equity Bank's mobile money service Equitel launched in August 2014. Equitel charged 1% of the transaction value capped at KES.25 per transaction.

M-Pesa's share of the mobile money subscribers market rose 4.8% to 77.4% in the period ending December 2014.

- 3) **November 2016** - Introduction of the "Kadogo" tariff which waived transaction charges for amounts up to KES.100 and allowed subscribers to send as little as KES.1.

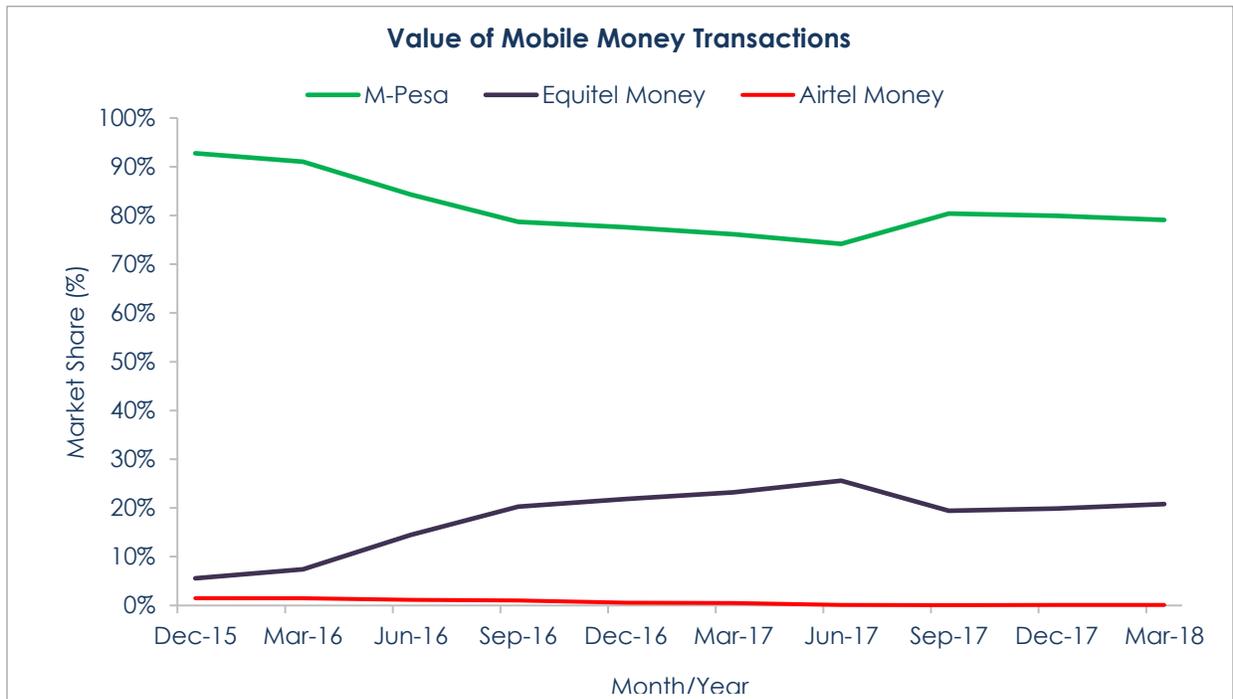
Safaricom's share of the total mobile money subscribers' market increased to 80% in March 2017 compared to 67.4% in December 2016 as a result of the introduction of the tariff. Airtel money lost its market share from 21.0% to 6.3% during the same period.

- **July 2018** - The Kenya government raises mobile money excise tax from 10% to 12% and then 20%. Safaricom responded by increasing M-Pesa tariffs (on the basis of the 10%-12% increase).
- We do not expect the new tariffs to have a significant impact on market share as we expect the competition to follow suit and revise tariffs.
- In addition, the comparative advantages enjoyed by Safaricom will continue to drive usage and revenue growth even if at a comparatively lower rate.

M-Pesa has pricing power in mobile money transfer business

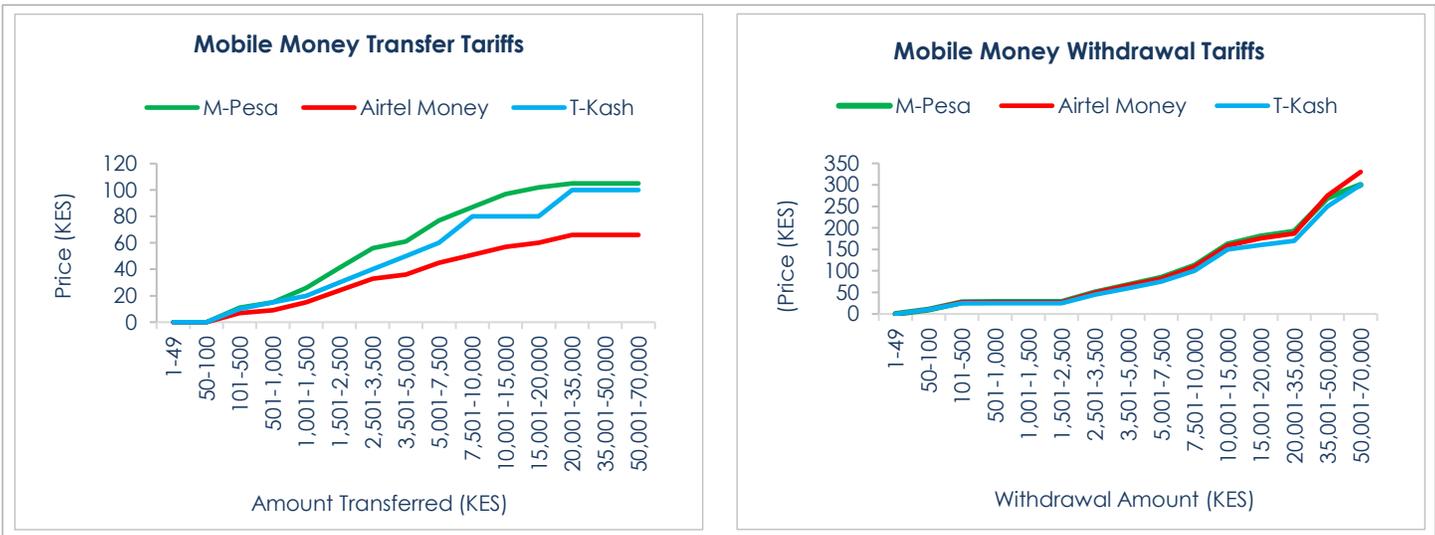
- Safaricom has gained 10% market share in the number of active subscriptions from June 2013 to 81% in March 2018.
- Despite charging higher fees than its rivals Safaricom has increased its transactional value by 96.2% to KES.1.4Tn by growing its M-Pesa customer base to 23.6Mn and its agents to 156,000 during the same period.
- For this reason we conclude that Safaricom has **pricing power** in mobile money transfer business.

Fig.3: M-Pesa unshaken in mobile money transfers



Source: Communications Authority of Kenya (CA)

Fig.4: M-Pesa comparatively more expensive than other mobile money transfer providers



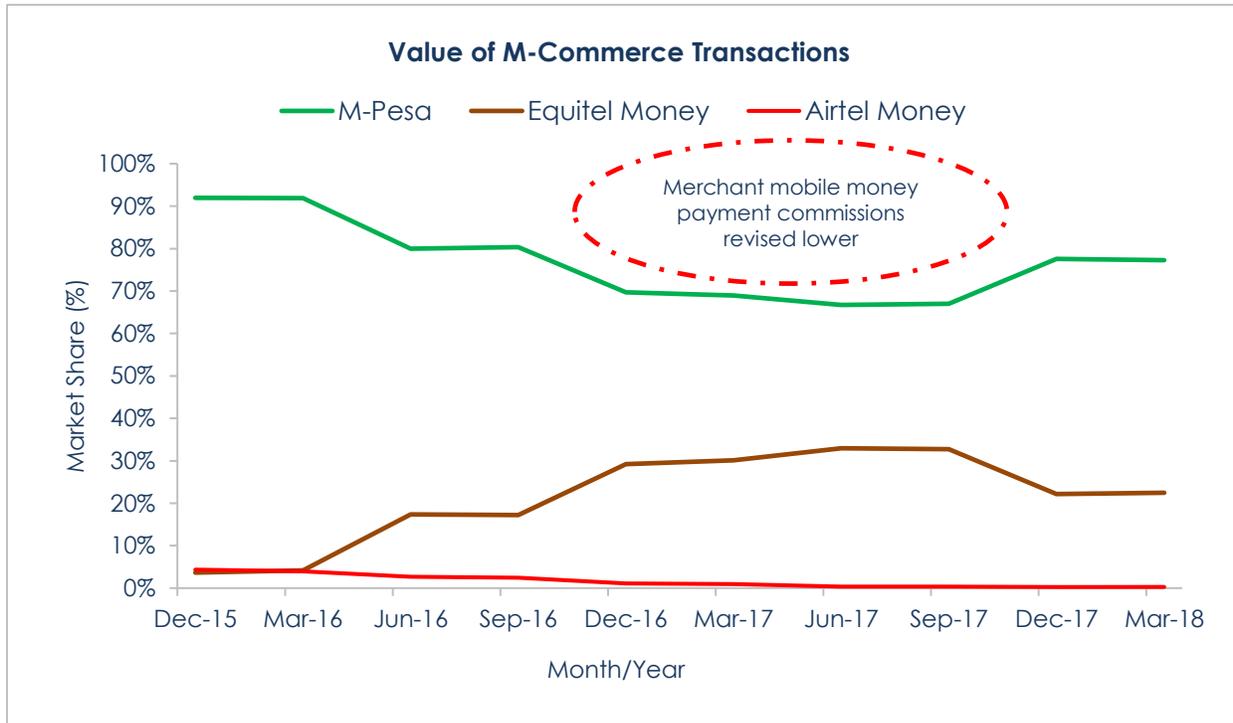
Source: Safaricom, Airtel Kenya & Telkom Kenya Tariff guides

M-Pesa losing its hold on mobile money payments

- Safaricom revised Lipa Na M-Pesa tariffs lower in response to Equitel’s market share gain in Q2 2016/17.
- In April 2017 Safaricom reduced all “Lipa Na M-Pesa”, Buy Goods merchant fees by close to 50% as a means of increasing the number of merchants using the payment platform.
- Under the new tariff, merchants are charged a maximum of 0.5% of the transaction amount, down from the previous maximum of 1.0%.
- Lipa Na M-Pesa merchants were charged a flat fee of KES 200, for any payments above KES.40,000.
- M-Pesa “Kadogo” tariff band under by eliminating merchant fees for all transactions below KES 100.
- The move was aimed at making the service more attractive than alternatives in the market especially Equitel whose M-Commerce market share stood at 30.1% (March 2017).
- The effectiveness of this strategy in growing market share is evidence of Safaricom’s **lack of pricing power in the mobile payment business**.
- Equitel’s growing strength in the mobile money payment business is attributable to the following:
 - 1) Equitel Eazzypay is comparatively cheaper for merchants as customer payments made through the platform are transferred directly into merchants’ Equity accounts at no extra cost.
 - 2) Equitel Eazzypay interoperability - Merchants can accept payments from all mobile money wallets, making it convenient to subscribers across all networks.
- Finserve recently launched a multi-functional mobile phone based application “mKey”.

- Through the App users can pay bills, send money to mobile wallets and social media platforms, and access loans based on risk-based pricing.
- mKey will present a new challenge to M-Pesa in the long term and could erode its market share of the mobile payment business.

Fig.5: Equitel's growing challenge to M-Pesa's dominance of mobile payments



Source: Source: Communications Authority of Kenya (CA)

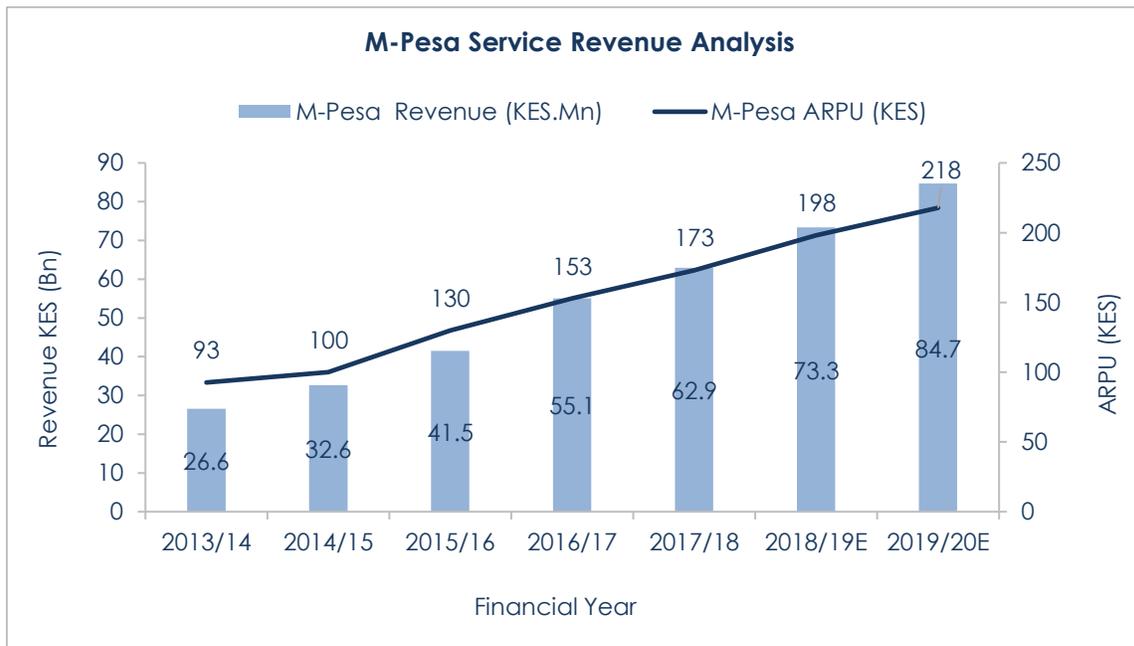
M-Pesa's dominance expected to continue amid regulatory threats

- Safaricom's market dominance in the telecommunications industry highly depends on the success of M-Pesa.
- M-Pesa continues to support Safaricom's subscriber numbers even as the other telcos on pricing competitiveness on most service lines.
- We cannot ignore the potential impact of regulation on the dominance of M-Pesa. The advantage Safaricom holds could be eroded if proposals made by Analysys Mason to the CA are adopted.
- The proposals that could have a significant impact on the market positioning of M-Pesa, its revenues and overall company profitability include:
 - 1) **Prohibition on surcharges for cross-platform money transfers:** Proposal for a uniform fee structure and fee level on transfers to registered and unregistered users, including users of other platforms.
 - 2) **Mandatory wallet-to-wallet interoperability and potential functional separation:** Wallet to wallet interoperability rolled out but ineffective. Agent wallet operability would have a significant impact.

M-Pesa's revenues to remain healthy even with the rise of Equitel

- Unlike other service revenues, we do not expect M-Pesa to come under significant competitive threat as it holds a considerable competitive advantage particularly in the mobile money transfer business.
- We forecast 16.6% growth in M-Pesa revenues FY2018/19 to KES 73.3Bn. Our growth forecasts are supported by the following:
 - 1) Increased subscription and active usage.
 - 2) Effective pricing and marketing strategies aimed at encouraging usage.
 - 3) Strategic business partnerships such as PayPal, Google services integration.
- We see a 5% growth in ARPU FY2018/19 to KES.277 driven by growth in customer money transfer transactions, payments and growth in fees from strategic business partnerships such as KCB M-Pesa and M-Shwari.
- Total service revenue contribution FY2018/19 estimated at 29.8% compared to 28% FY2017/18.
- We predict that M-Pesa service revenues contribution will be higher than voice calls by 2021.

Fig.6: M-Pesa's could be the biggest service revenue driver by 2021



Source: Company filings & Sterling Capital estimates

Disclosures:

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