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# Topical Note

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**Safaricom Plc**

**“Safaricom dominant. Fact or fiction?”**

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## Executive Summary

- Our 5th topical note “**Safaricom dominant. Fact or fiction?**” focuses on Safaricom Plc’s “Safaricom” market positioning in the Kenya telecommunications industry and specifically covers the area of market dominance.
- We intend to determine whether Safaricom is indeed dominant or is perceived as the dominant player by the regulator the Communications Authority (CA), its competitors and customers.
- Our report first gives a brief description of the concept of market dominance according to the Competition Authority of Kenya (CAK).
- The theoretical market concept of market concentration the Herfindahl Hirschman Index (HHI) is also used to capture evidence of Safaricom’s market dominance.
- Using HHI, we see that Safaricom enjoys a significant dominant market position compared to its peers in selected countries on the continent.
- The CAK clearly states that there is nothing wrong with market dominance but prohibits its abuse and gives instances where an industry player’s business actions translate to abuse of dominance.
- Our report identifies few examples of cases of abuse of dominance.
- Finally our report refers to some of the proposals made by Analysys Mason an independent consultant commissioned by the Communications Authority (CA) to analyze the Kenya telecommunications industry.
- The proposals, reasons behind them, the potential impact and the likelihood of implementation are covered.
- Our report concludes that most of the proposals made by Analysys Mason are unlikely to be implemented and Safaricom will remain dominant in the industry for the foreseeable future even with its market share declining.

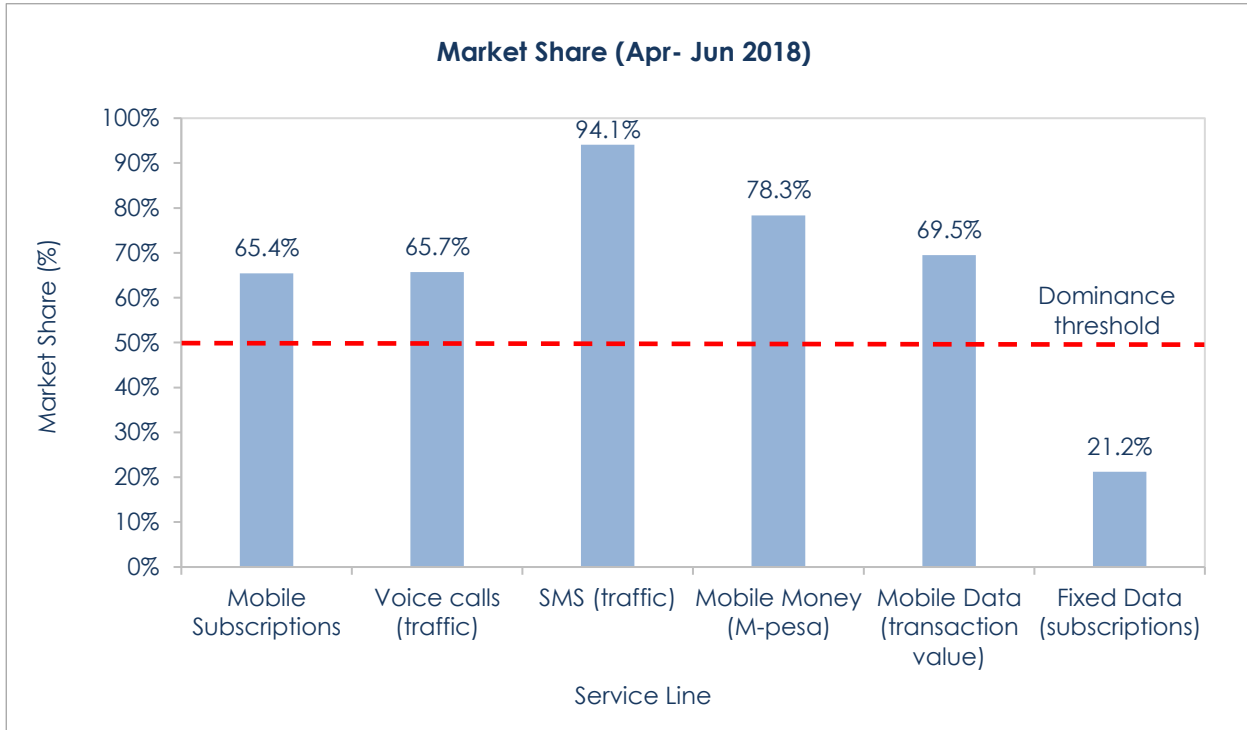
## Explaining the concept of market dominance

- Entity that produces, supplies or distributes more than half (50%) of the total goods that are produced, supplied or distributed or controls not less than half (50%) of the services that are rendered. - **Competition Authority – Kenya (CAK).**
- The ability of a company to maintain the prices of its products and/or services above a competitive level. Market power arises in a number of industries as a result of factors such as economies of scale that act as barriers to entry and thereby reduce the number of efficient market players, or the use of switching costs that limit the ability of customers to move to new suppliers. It is deemed to exist where a company, "either individually or jointly with others enjoys a position of economic strength affording it power to behave to an appreciable extent independently of competitors, customers and ultimately consumers." - **Analysis Mason - Consultant**

## Safaricom is dominant - Market Share +50% (CAK)

- On the basis of the market dominance definition by the CAK, we conclude that Safaricom is dominant in all its service lines with the exception of fixed data where it holds a 21.2% share of total subscriptions (Fig.1).
- On fixed data we once again refer to the CAK "Where a company has less than 50% market share, the Authority will consider whether it has market power or has the ability to exercise market power. It may consider whether it can set prices, outputs or trading terms without being effectively constrained by its customers or competitors in the relevant market."
- We conclude in our November 2018 Pricing Power report "**Is Safaricom losing its grip? - Fixed Data - The New frontier.**" **that Safaricom is not dominant in the fixed data business but holds market power.**
- That is, it is in a position where it can set prices (fixed data tariffs), output (service coverage) and trading terms with minimal constraint by its customers or competitors.
- The reason for this being its superior network quality, fast increasing coverage and brand name, which override the comparatively higher price it charges its customers for the service.

**Fig.1: Safaricom dominates the mobile telecommunications industry**

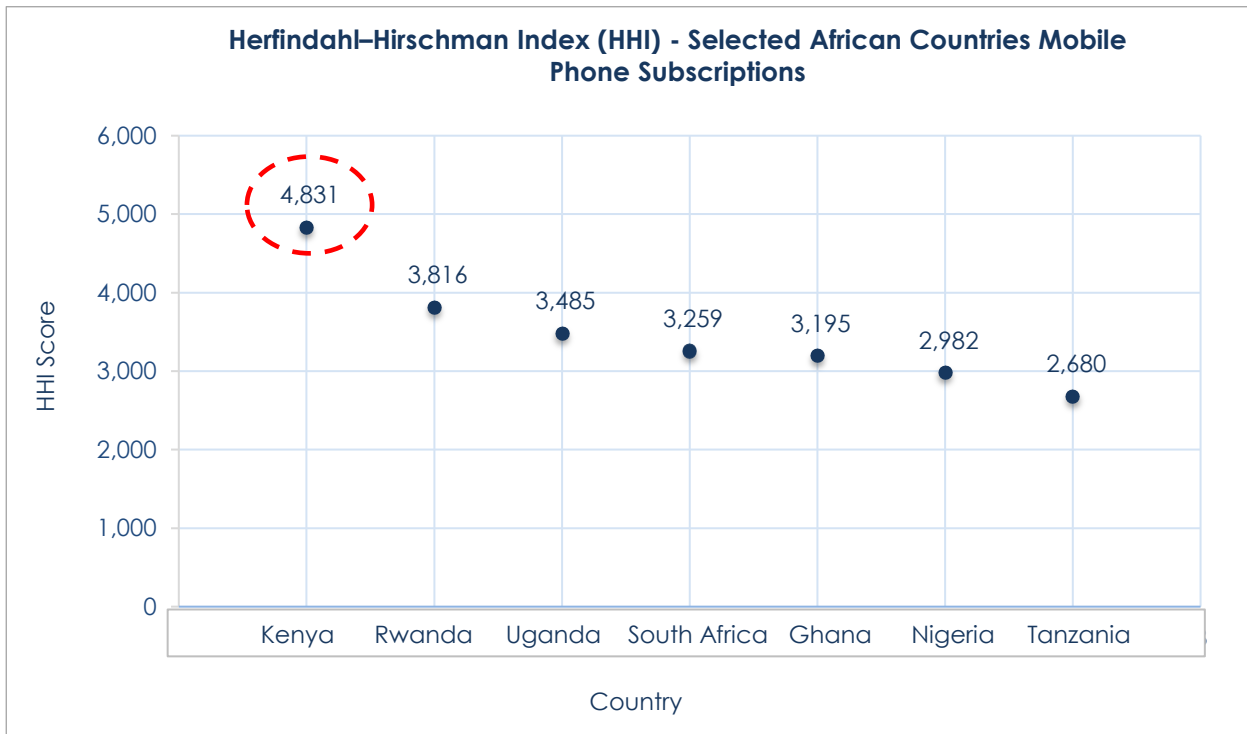


Source: Communications Authority of Kenya (CA), Sterling Research & CFA Institute

### HHI Score shows Safaricom's dominance

- Further evidence of Safaricom's dominance is illustrated using the Herfindahl-Hirschman Index (HHI) theoretical concept of market concentration.
- HHI measures the size of a firm in relation to the industry and is therefore a measure of the concentration level of an industry.
- The HHI score ranges from 1 (low concentration - perfect competition) to 10,000 (high concentration - monopoly).
- The higher the HHI score, the higher the level of market concentration.
- The Kenya mobile telecommunications industry has a HHI score of 4,831, indicating high concentration.
- This is however significantly lower than 5082, at the end of 2015 (the score quoted by Analysis Mason in the report on Safaricom's market dominance), suggesting growing competitiveness of the industry.
- Kenya's telecommunications sector has a high HHI score compared to selected countries (Fig.2).
- With 65.4% of the total market subscribers, Safaricom also holds the highest market share amongst our comparable companies with MTN Ghana (47.6%) and Vodacom (South Africa) 40% the next highest.

**Fig.2: Kenya's telecommunications industry is highly concentrated with Safaricom dominant**

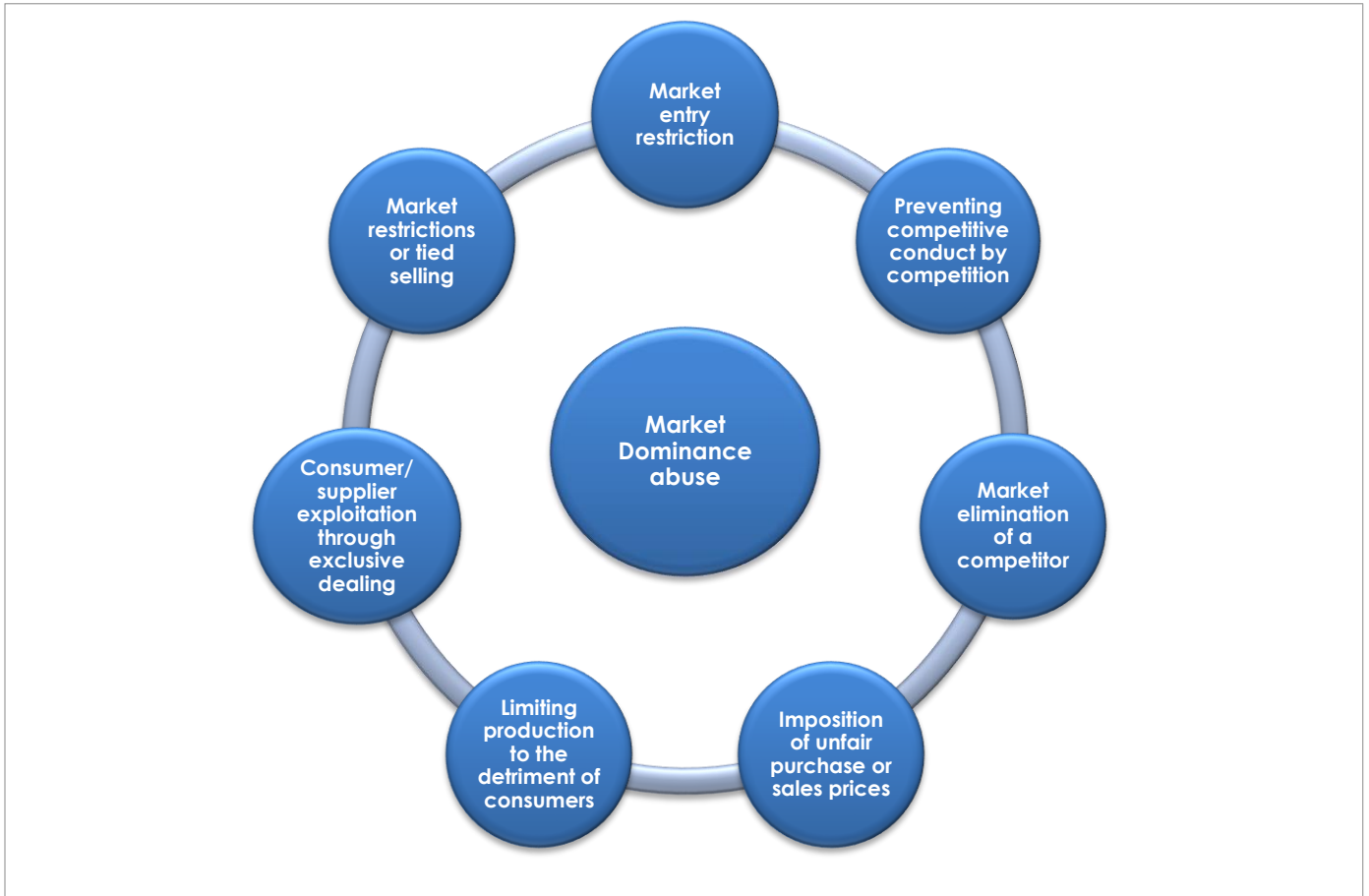


Source: Communication Regulatory Authorities

**Nothing wrong with dominance but everything wrong with its abuse**

- In reference to the CAK, holding a dominant market position is not prohibited. However abuse of a dominant position is illegal and may be subjected to regulatory action.
- Fig.3 shows examples of cases of abuse of dominance according to CAK:

**Fig.3: Examples of abuse of market dominance according to the competition regulator**



Source: Competition Authority Kenya

**Has Safaricom abused its dominance?**

- We have used the CAK's guidelines as a basis of determining whether Safaricom has abused its dominance and see some cases of the same:

**1) Consumer/Supplier exploitation through exclusive dealing** - Safaricom has in the past restricted its M-Pesa agents from working with other mobile operators by threats of loss of accreditation.

With Safaricom holding a significantly large share of the mobile money business we believe that this fear of loss of accreditation worked in its favour with dealers resorting to exclusive M-Pesa dealership.

- 2) Discriminatory Pricing** - Safaricom has differentiated pricing for unregistered M-Pesa users compared to registered M-Pesa users.

This discriminatory pricing strategy in our view has been effective in compelling mobile subscribers many of whom are highly price sensitive to choose Safaricom as their preferred operator.

- 3) Imposition of high prices on consumers** - Safaricom's tariffs are significantly higher than its competitors in virtually all its service lines.

We believe that Safaricom has taken advantage of its market positioning, its network infrastructure and coverage advantages, its distribution network to charge a premium tariff to its customers.

- 4) Market restrictions or tied selling** - We see evidence of tied selling in the following practices:

- a) Sale of headsets at Safaricom retail outlets where would be twin sim phones are configured to accept a single sim card.

This is a deliberate effort by the operator to ensure that phone buyers are restricted to using a single operator for all mobile services.

With Safaricom enjoying a strong advantage in mobile money services particularly, subscribers would find it cumbersome to keep switching sim cards to use other comparatively cheaper services provided by other operators.

- 5) Preventing competitive conduct by competition** - Safaricom resisted wallet-to-wallet interoperability\* with other mobile wallets when it was first proposed with the fear that this would erode the advantage it enjoys in mobile money services.

Account to account interoperability was implemented in April 2018 but has had minimal effect on MPesa market share since implementation.

It remains highly opposed to agent to agent operability where agents operate a single float accessible to users of the different mobile service operators.

With a network of almost 160,000 agents Safaricom believes that it would be unfair for other operators to use its existing agent network, one they have invested extensively in building as a key area of competitive advantage.

\* **Wallet-to-wallet interoperability** - allows users to seamlessly transfer funds across M-Pesa, Airtel Money and T-Kash in real time.



## Safaricom's dominance has been good for its business but is it under threat?

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- There is little doubt that Safaricom has benefitted immensely from its dominant market positioning.
- We see a positive association between financial performance measured by profitability, return on assets and market concentration measured by HHI and Market share.
- Investors however are more concerned about the sustainability of this dominance and whether it is under threat.
- In our 6 part series "**Is Safaricom losing its grip?**" we indicated that Safaricom has been losing market share in total mobile subscribers as well as service lines such as voice calls and mobile data.
- The market share decline has been largely attributable to downward tariff adjustments by competition which have been effective as mobile service subscribers are highly price sensitive.
- This loss of market share has slowed down revenue growth (in the case of voice, industrywide decline in voice call and messaging traffic volumes is also credited with the decline).
- **This is a clear sign of declining dominance and in our view somewhat reduces the possibility of regulation imposed to reduce its dominance.**

## Analysis Mason's proposals might be nothing more than "hot air"

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- In 2016, the Communications Authority of Kenya (CA) contracted Analysis Mason an independent consultant to analyze the local telecommunications industry.
- Several proposals were made to counter Safaricom's dominance of the industry (Fig.4).

**Fig.4: Analysys Mason's proposals unlikely to be implemented**

|    | <b>Proposal</b>  | <b>Reasons behind proposal</b>   | <b>Potential Implication</b>  | <b>Likelihood of implementation</b>  |
|----|--|--|---|--|
| 1. | Split M-Pesa from Safaricom  | - Increase industry competitiveness especially in the mobile money business where Safaricom is clearly dominant.   | - Modalities of the proposed split unknown.<br>- For this reason we are unable to give an informed opinion on its implication.    | - Likelihood of implementation depends on the modalities of the split.<br>- We see this as highly unlikely.  |
| 2. | Tower sharing of infrastructure in 14 counties where communications infrastructure is lacking. Then halved to seven. | - Costly for smaller operators to extend coverage in areas of low population density due to low market share and high cost of tower sharing.                             | - Increased service coverage by smaller operators will increase competitive intensity.  | - Safaricom has invested heavily in network expansion over the years and this is being one of its key sources of competitive advantage will face stiff resistance.                             |
| 3. | Prohibition of individually tailored loyalty schemes and promotions.   | - Lack of transparency in pricing and marketing strategies leading to subscriber discrimination.   | - Increase the cost of providing loyalty schemes.   | - We do not see this as a high impact move and will be largely ineffective if implemented.   |
| 4. | Replicability of retail tariffs  | - Safaricom engaged in margin pricing to lock out operators who cannot match the same profitably.  | - Tariffs and loyalty schemes and promotions replication unlikely to have a major impact on Safaricom's market positioning.       | - Unlikely and ineffective if implemented as competitors prefer to engage in price competition to gain market share and do not need to replicate Safaricom's pricing and marketing strategies. |
| 5. | Safaricom should provide 2G, 3G and 4G roaming services to competitors for 5 years in 14 counties.                   | - Lack of coverage limits competing operator's ability to acquire subscribers in non-covered areas.  | - Improvement in operators' network coverage will improve competition intensity.  | Unlikely – Safaricom likely to resist this move after heavy capital expenditure.   |
| 6. | Prohibition of surcharges for mobile money transfers to unregistered users and cross-platform transfers.             | - Safaricom has used discriminatory pricing in mobile money, SMS and voice calls and removal of this advantage will increase competition amongst mobile money operators. | - Mobile subscribers choose cheaper operators and could force Safaricom to revise its tariffs downwards to maintain market share. | Moderate chance of implementation with high resistance from Safaricom expected.  |
| 7. | Prohibition of on-net discounts  |  |   |  |

|    | Proposal                          | Reasons behind proposal   | Potential Implication   | Likelihood of implementation  |
|----|-----------------------------------|---|---|---|
| 8. | Wallet-to-wallet interoperability | - Wallet-to-wallet interoperability (person-to-person transfer across platforms requires the recipient to withdraw the money in cash from an M-Pesa agent and then pay it in at an agent for the recipient's own platform.) | - Wallet-to-wallet interoperability has since been implemented but largely ineffective because of competing operators' limited agent network.   | - Already Implemented   |
| 9. | Agent interoperability.           | - Agent operability will enable agents support multiple mobile money platforms using a single float.<br>- Move aimed at reducing Safaricom's dominance in the mobile money business.  | - Agent operability would give mobile money subscribers irrespective of network operator, access to Safaricom's wide agent network.<br>- Erosion of Safaricom's mobile money market share as its high tariff will reduce its competitiveness. | - Unlikely - Safaricom has resisted this move as it has invested heavily in building its large agent network which is a key competitive advantage area. |

Excerpts of Analysis Mason Report

| Chance of implementation | Indicator   |
|--------------------------|---|
| Very Likely              |  |
| Moderate                 |  |
| Unlikely                 |  |
| Already implemented      |  |

- We see a low chance of these proposals being implemented for the following reasons:
  - 1) Several of the proposals ignore Safaricom's heavy capital expenditure to develop its current positioning and any move to share its service coverage and agency network could result in stiff resistance and litigation.
  - 2) Recent market trends showing Safaricom loss of market share suggests that competition intensity is increasing courtesy of market forces and there need not be any regulatory intervention to reduce its dominance.
  - 3) We do not see significant commitment from the regulator to implement these proposals or take any action in the absence of evidence of undesirable effects on mobile phone subscribers.
- In conclusion **we do not see threat of regulation as proposed by Analysys Mason as the biggest threat to Safaricom's market position.**
- Its biggest threat comes from its competitors pricing and marketing strategies that continue to see them gain market share.

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