Institute of Economic Affairs

Memorandum Presented to the Communications Authority on the Study Findings on: Competition in the Telecommunications Sector in Kenya Held on Tuesday, 20th February, 2018 At The Stanley Hotel, Nairobi

Introduction

The Institute of Economic Affairs is a public policy think tank based in Nairobi. Its seeks to improve public welfare by undertaking policy research and hosting policy dialogue in order to inform decision making through dialogue and participation in public processes.

This is a memorandum prepared by the Institute of Economic Affairs (IEA-Kenya) based on an invitation by the Communications Authority on Kenya for the public to prepare memoranda based on the presentation of a study undertaken by Analysys Mason on behalf of the Communications Authority. This memorandum by the IEA-Kenya contains proposals on the findings communicated during the Workshop hosted on February 20, 2018.

We note that the presentation was made in plenary but that there were no prior reports or summary of the findings and therefore our proposals are based entirely on the notes that we took during the presentation. We outline each issue of concern separately and explain the context before making policy proposals and comments upon each in turn.

Part A: Comments on the Process

Issue 1: Presentation of the Report

As already highlighted in the introduction above, the Communications Authority of Kenya issued a public notice for the meeting and mentioned the full agenda for the same. This is laudable as it is consistent with declared principles of state policy making according to Kenya's constitution. However, meaningful public participation does require that the Communications Authority should have circulated either a summary or the full report to enable the public and professionals to interrogate the findings in details prior to the meeting. In the view of the Institute of Economic Affairs (IEA-Kenya), this was a material failure which undermined the ability of Kenyans to participate and interrogate the findings of the report. This was a report of significance to Kenyan consumers, professionals in the sector and other policy actors and the Communications Authority placed the public in a position in which most discussions were based on assumptions and taking the interpretation of the research team at its word.

Rationale:

Public participation is a declared principle of the Kenyan constitution and therefore state corporations such as the Communications Authority are expected to adhere to the basic principles. It is expected that a meeting of this significance should not only provide a subject of the discussion but also ensure that interested consumers, citizens and other professionals are able to participate meaningfully. In the absence of basic material on the findings, it is clear that this principle was violated in practice and affected the overall effectiveness of the session.

As a minimum, all instances of public consultation should include the following;

- **Adequate Notice**
- **Background and the description of the study**
- **Summary report to enable preparation**
- **Further communication on the final release of report**
- **Feedback to the public at the conclusion of the event**

Recommendation:

The Communications Authority should take note that point three and five of the list above were not met and commit to adherence for all future instances of public participation.

Part B: Substantive Comments on the Content of the Report

Issue 2: Proposal for Sharing of Infrastructure

The Consultants stated the finding that, one of the key impediments to thriving competitive industry pertains to Infrastructure. More specifically, this refers to towers that each firm in the industry needs to invest in to reach their intended consumers. It noted correctly that a vast majority of the towers and base stations countrywide are part of the investments made by Safaricom Kenya Limited. In order to cure this problem, the report proposed a policy change to require the sharing of infrastructure in 7 counties that the consultant noted are the most disadvantaged in terms of connectivity and network availability. These counties are; *Garissa, Turkana, Marsabit, Mandera, Samburu, Wajir and Isiolo.* This sharing is to be initially for a five-year period.

The report noted that this is based on the disadvantages faced by consumers in these counties in terms of inadequate access to telecommunications services. That Safaricom Kenya Limited should therefore be compelled to lease its facilities to willing competitors for a fee to be determined by the Communications Authority through regulatory price setting.

Based on the presentation made during the dissemination meeting, it was not clear that there are very large constraints to investment in setting up transmission infrastructure. It ought to be the responsibility of the Communications Authority to ensure effective use of the Universal Service Fund to support investment in key infrastructure for the industry in areas with inadequate access. However, even if the finding that the absence of infrastructure has undermined competition is defensible, the proposal for price caps on interconnection charges is not persuasive

Rationale:

The Universal Service Fund has substantial resources that should be used by the Communications Authority to ensure the extension of critical infrastructure. At the same time, the IEA-Kenya is concerned that the report recommended that the costs of infrastructure sharing should be fixed by the regulator. This preemptive approach assumes that the firms in the industry are unable to negotiate prices among themselves. The compulsion of Safaricom Kenya Limited or other market players to share their infrastructure with competitors is a disincentive for infrastructure investment because it sends the signal that the state may appropriate that infrastructure and allow it to be used by a competitor.

Recommendation

The Communications Authority should explore use of the Universal Service Fund to establish infrastructure in the seven counties because this responsibility is legally placed in its domain. This policy would only be defensible where the infrastructure was wholly established by public investments and that is not true for this situation.

Issue 3: No to Splitting of Safaricom

The basics of competition in a given market require that there should be a perfect competition. This is one which allows for ease of entry and exit by firms, where competitors are price takers pushed by forces of demand and supply, and products (goods and services) are identical. While noting this development, it was raised by the consultant that the lead firm – Safricom – would not be split to its various platforms; Mobile Money, and Voice & Data.

This is one of the key recommendations that were brought forth by the consultant and reiterated by the Cabinet Secretary for Information Communications and Technology (ICT). Splitting of Safaricom was clearly not an option.

Rationale:

This was premised on the fact that Safaricom Kenya Limited had grown in leaps and bounds in terms of diversifying its service offers. Kenya's law recognizes the existence of dominance but only considers regulatory action where there is evidence of its abuse and adverse effects on consumers and competing firms. The report did not establish that either of these standards was met and the recommendation that there should be no adverse action against any firm in the industry is sound policy advice.

Recommendation:

We note that the Competition Authority has in its guidelines rules and regulations that govern dominance. The Competition Act 2012, Section 4 outlines the threshold required for a firm to be declared as being dominant. Parts 3(a) and (b) clearly states that a 50 percent threshold means that an operator is dominant in a particular industry. In as much as splitting is not a feasible option, it is in the best interest of the country to ensure that dominance, and especially abuse of it, is checked henceforth.

Issue 4: Creation of a Shared Platform – Mobile Money Wallet

While the proposal to have a mobile wallet is welcome, it is important to note that Safaricom accounts for over 70 percent of customers on voice and data, as well as on the mobile money platform. The closest challenger is Airtel Money, while Telkom (formerly Orange Kenya) have also rolled out their products.

Analysys Mason proposes inter-operability be allowed more as pertains to transfer of money across different mobile money platforms. The consultant also proposed that extra charges on cross-network mobile cash transfers be scrapped. This is aimed at making the service cheaper and more affordable on the one hand, while also enabling agents to use their float across the available platforms.

This in the view of the IEA is a welcome move and will go a long way in ensuring not only inter-operability on the mobile money platform, but may also foster growth in the number portability platform, which is slowly gaining traction in the market. Allowing this kind of service will also allow deepening and wider outreach thus strengthening financial sector deepening.

Issue 5: Findings on Competition and Abuse of Dominance

Among the main justifications for the study was the need to examine the claims of dominance and abuse of dominance by market players in the industry. This report examined this and made the point that dominance was an issue of concern both for the regulator and consumers. Based on the presentation, the report did not clearly state that any firms were found to have clearly abused positions of dominance in the market. It made recommendations that the regulator should be permanently vigilant to check all market segments to ensure that consumers are not harmed by the behavior of firms that are dominant. The Institute of Economic Affairs (IEA-Kenya) notes that there is no doubt that dominant position may be abused and that the success of the communications industry in Kenya has been achieved through promotion of market competition. We considered the findings of the report as relevant but incomplete because the Competition Authority of Kenya is the proper statutory body to make findings on the existence of dominance and its abuse in Kenya.

Rationale:

It is evident that the market study has revealed insights about the industry and examined closely the impediments to competition. We contend that some of its proposals for managing them are inconsistent with Kenya's competition law and should be examined by the Competition Authority.

Recommendation:

The Communications Authority of Kenya is right to be concerned about dominance and its abuse. However, the proper institution that should dispassionately examine and determine the existence of dominance, its abuse and remedies is the Competition Authority. Thus the Competition Authority should reexamine the findings in the report and conclude its own study on the degree of competition in Kenya's competition market and proceed with administrative action that is consistent with the Competition Act.

Issue 6: Retail Interventions and the National Roaming

- **Restrictions on the range of tariffs, schemes & promotions available to customers**
- **Increased costs to consumers**
- **Restriction on tariff innovation**
- **Increased administrative burden leading to increased regulatory costs**

The consultants recommended specific restrictions on the variety of tariffs, schemes and promotions that any firm in the industry may adopt for its marketing and promotions. This recommendation suggests that there is a market distortion that results from any firm adopting marketing means that its teams consider relevant. Based on the presentation made during the dissemination workshop, this appears to specifically target Safaricom Limited and is purely directed at curbing the range of marketing options that this firm may adopt. The IEA-Kenya consider this policy proposal to be based on a preposterous claim for which the consultants have provided proof. However, it appears to have the support of some of the firms that compete in the market and who may not favour the broad marketing strategies and tactics of their competitors.

It is the View of the Institute of Economic Affairs (IEA-Kenya) that there neither a policy imperative nor any economic justification for restrictions of a firm to engage in lawful marketing of its services and products. This policy initiative is not only without merit but also dangerous creep upon constitutional freedoms that firms may have to communicate their services through advertisement and marketing initiatives. Firms ought to be free and retain the liberty to innovate and apply their knowledge of their markets to provide information that allows their customers to use their services and products. This is among the most unreasonable restrictions proposed in the report and has no value for consumers or the total market value.

Rationale:

In particular, the limitation on promotions available to customers would mean that the discovery cost for consumers of these services would be much higher because the range of communications available would be reduced. This policy proposal serves no purpose either in aiding competition or raising the health of the industry and is strictly outside the scope and terms of reference that were communicated. The existence of these schemes and promotions and their proliferation is a clear signal of a healthy market. In addition, the schemes and promotions are not without cost and no firm would use them if they did not have market value. Their popularity suggests that consumers find that they have high utiliy and are worth paying for.

Secondly, our analysis of the specific restrictions above reveals that their invocation as policy would raise the cost of services to all consumers of services. Restriction on the implementation of a variety of tariffs that each firm may provide would harm the consumers of these services. This proposal does not even meet the most elementary principles of market competition. The reason for our claim is that an introduction of various tariffs is an internal research mechanism for the network operators to determine the differences among their clients and to enable them to design specific tariffs that are more suitable for categories of clients. To force firms to utilize the same tariff structure for all clients is preposterous and suggests little understanding about the nature of these services and the variety of clients that are served by modern communications firms.

Thirdly, the proposal to have single tariff is a hindrance to internal research that leads to market innovation in respect of tariffs. It is evident to any economist that this industry serves many people with different preferences and that meeting their needs must lead to segmentation and differentiation of tariffs. And the most salient market signal should come from consumers of the service and not by this regulatory policy proposal. If a firm chooses a model of tariffs that is not favoured by the customers then it is expected that the market will shrink and that is the signal that the choice is wrong. It is not the responsibility of the regulator to ensure that all firms have the right tariff policy because the market dynamics demonstrate that there is no single tariff policy possible when serving millions of consumers with different preferences Finally, the proposals contained in the prescribed retail interventions would increase the cost of services to consumers. This is because the operators would have to adjust tariffs towards the highest costs for all consumers without the ability to pass savings back to customers whose use is efficient. And that some of these proposals would have the unintended consequence of raising costs for consumers would render the entire regulatory policy a failure.

Recommendation:

The proposals related to restrictions on tariff innovation, standardization of all tariffs and reduction of schemes are inconsistent with promoting a competitive industry and would harm the consumers. For that reason, it is clear that they should be expunged from the report and the autonomy of all firms retained in respect of pricing services and innovation regarding their marketing initiatives. To restrict ability of firms to set their own prices is a price control scheme that is inconsistent with Kenya's overall economic policy posture and would violate the norms of policy making in the country.

Issue 7: Prohibition of Cross-platform Surcharges

One of the largest contributors to Safaricom's revenue stream is through transactions on the mobile money platforms. Introduction of a uniform charge here will mean that the company may be forced to increase their charges in other services to cover for lost revenue. This increases cost of services and is not healthy for a competitive market. Consequently this has the ability to create cost and economic distortions in the industry and market at large.

Rationale:

The main reason is have a uniform platform that allows cross-network transfer of funds at a uniform cost – not taking into account the costs that one company may be incurring to offer the same service viz-a-viz the other.

Recommendation:

The costs associated with money transfer vary across the various platforms in the market. In this respect, each company charges in line with their perceived operational risks bearing in mind the ultimate aim of making profits to offset its liabilities and also pay its shareholders. In order to promote this therefore, there needs to be an empirical analysis of the effect that this will have on the industry players. Is it meant to benefit the consumer to the detriment of the company, or is it of mutual benefit, and what is the period of time over which this will be applied? IEA-Kenya foresees a situation where a simulation should be undertaken to ascertain the effect of this move on the industry in the short, medium, and long term.

Noteworthy, surcharge prohibition would prevent cost-reflective pricing (anti-competitive practices) which could in the end result to unintended consequences within the industry and the economy at large.

The Institute of Economic Affairs (IEA - Kenya) is a Public Policy Think Tank and Kenya's premier dialogue forum that seeks to promote pluralism of ideas through open,active and informed public debates on key policy issues, and to propose feasible policy back-up to policy makers including members of parliament as well as through reserach and advocacy. Through its work, The IEA-Kenya provides alternative public policy choices and addresses the legal and institutional constraints to economic reforms and growth.

The IEA-Kenya is independent of political parties, pressure groups, lobbies and any other partisan interests, and its only interest is the generation of cutting edge knowledge to inform the public while contributing to the formulation of rational public policies.

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