Doc No. 25/EACO/G/8/2023

East African Communications Organisation

Communications for all in East Africa

A GUIDELINE FOR COMPETITION ASSESSMENTS IN THE COMMUNICATION SECTOR

Prepared by EACO

JUNE 2023

1.0 BACKGROUND

The Communications Industry within the East African region has grown over the years. The sector is so dynamic in that business models in its vast array of services ranging from telecommunications, posts and courier services, multimedia services, Short Messaging Service (SMS), and Unstructured Supplementary Service Data (USSD) technologies among others change by the day.

The growth in these services has led to a purported average economic growth in the region of over 40%. This growth is largely driven by the innovation of large multinational and local enterprises and Small and Medium-Sized Enterprises (SMEs).

2.0 PROBLEM STATEMENT

The growth in the industry has presented several challenges to regulators, operators, and customers within the region.

From a regional perspective, the East African Communications Organisation (EACO) developed its new Strategic Plan which will run for the period FY 2018 – 2023. Key among the strategic focus areas of the plan was to develop and promote Consumer Rights Protection, Consumer education & Operators' obligations in the region.

It is this mandate that obliges EACO to develop timely interventions to promote market deepening, fairness, healthy competition, and innovation which will outright lead to Consumer protection and a wide choice of ICT products and services.

The diversity in outlook and size of the actors in the different ICT markets within the region coupled with the lack of harmonized and irregular competition assessments present commercial, anti-competitive and antitrust challenges that EACO is best placed to address.

In pursuit of these obligations, EACO under the Working Group 6 commissioned as part of its cycle outputs the development of a guide for competition assessments within the communications sector.

3.0 REVIEW OF THE REGULATORY FRAMEWORKS

It is imperative for each regulator under EACO to develop or structure any intervention based on the parent Act. Consequently, all National Regulatory Authorities (NRAs) will for the sake of this document refer to their parent laws namely,

a) Uganda – the Uganda Communications Act (2013)
b) Burundi - Law No 100/182 of 30 September 1997 - Agence de Régulation et de Contrôle des Telecommunications (ARCT)
c) Kenya Information and Communications Act (1998)
d) Rwanda - Law No. 24/2016 of 18/06/2016 governing Information and Communication Technologies (2016)
e) South Sudan - South Sudan National Communications Act (2012)
f) Tanzania – Electronic and Postal Communications Act, (2003)

4.0 WHY THE NEED FOR MARKET DEFINITIONS?

The European Union (EU) defines a market definition as a tool to identify the boundaries of competition between undertakings. The objective of defining the relevant product and geographic market is to identify the actual competitors that constrain the commercial decisions of the undertakings concerned, such as their pricing decisions.

A market definition is regarded as the first step in competition analysis. This is because the mechanism is a widely celebrated mechanism in mergers and abuse of dominance cases, particularly in the United States as well as Europe.

It is from this perspective that the market definition makes it possible, among other things, to calculate market shares that convey meaningful information for the purposes of assessing market power in the context of mergers, antitrust proceedings, or any other competition issues in any regulatory environment.

5.0 CONDUCTING COMPETITION ASSESSMENTS FOR EACH RELEVANT MARKET

This section will serve as a guide to all EACO regulators in assessing their industries using the Structure-Conduct-Performance (SCP) framework. The SCP paradigm suggests that the industry's performance, the success of an industry in producing benefits for consumers, depends on the conduct, and behavior of sellers and buyers, which depends on the structure of the market. As such it would be possible for any regulator to weave out any competition concerns.

The structure, in turn, depends on basic conditions such as technology and demand for a product. Typically, the structure is summarized by the number of firms or some other measure of the distribution of firms, such as the relative market shares of the largest firms (Perloff, Karp, & Golan, 2007).

Figure 1: SCP for EACO Regulators

Structure
•Industry concentration
•Number of players
•Market share
•Barriers to entry
•Regulatory and legal

Conduct
•Pricing and product offering
•Customer retention
•Innovation
•Mergers and acquisition (M&A)

Performance
•Revenue growth
•EBITDA margin
•Return on equity (ROE)
•Return on asset (ROA)
•Lerner index

1. **Key Issues of evolution**

The definition of the market of interest is key in SCP analysis. The markets of interest for EACO include Telecom, Post and Courier, Broadcast and Multimedia, USSD, and SMS markets as well as the infrastructure markets. The evolution of the different service layers, therefore, has to be taken into consideration for example,

a) Dominance of mobile communications the shift in business strategy from voice and short messaging services to data and internet-connectivity services and Digital Financial Services.
b) Entry of domestic transport services as small scale domestic courier operators and the emergence of e-commerce players
c) Emergence of VAS aggregators and other DFS players in the USSD and SMS space
d) Potential bilateral agreements in the infrastructure space and the emergence of
e) Emergence of International Content service providers like Netflix and the existence of rights agreements between local and international content providers and signal distributors
f) Retail and wholesale service layers across the different markets
g) The geographic scope of the market

2. Structure

Market structure is often characterized by the number and relative size of the firms (industry concentration) and the ability of firms to enter the industry (barriers to entry). For the former, the expectation is that firms will exercise more market power if there is only one or a few firms or if a small number of firms are very large relative to the remaining firms. For the latter, in industries with significant long-run entry barriers, prices can remain elevated above competitive levels.

a) Industry concentration, number of players and market share

The EACO Communications market will look out for the levels of market concentration using the Herfindahl-Hirschman Index (HHI).

$$HHI = s_1^2 + s_2^2 + s_3^2 + \dots s_n^2$$

s_n =the market share percentage of firm n expressed as a whole number

This industry concentration level should be analyzed in the context of anti-competitive practices such as collusion, cartels, and tying and bundling of ICT products and services of mergers and acquisitions (M&As) in the market.

b) Barriers to entry

The telecom industry for example poses significant barriers to new entrants: regulatory and legal, economic, and possible strategic actions from incumbents that increase entrant's costs. Congressional franchise and license to operate, spectrum allocation, and large fixed capital requirements are long-term barriers to entry.

Once these hurdles are surmounted, short-term challenges present themselves such as decentralized local government unit (LGU) regulation for permits and taxes, and possible strategic actions from incumbents (on access, interconnection, product lock-in, etc.) that increases entrant's costs (Hauge and Jamison, 2009).

Thus, the industry lags behind in terms of contestability or the freedom of market entry and exit; contestability is important as studies have shown that even the threat of a new entrant will improve the quality of service and pricing of current market players (Baumol, 1982; Baumol, Panzar, and Willig, 1982).

3. Conduct

Conduct refers to how players respond to market incentives and competitive pressures. Key indicators of conduct include relative pricing and product offering, customer retention, product innovation, and service quality among others. The market structure seems to influence the conduct of market players.

Given the ICT industry structure, each firm must consider how its actions will affect its rivals, and how they are likely to react. As such, it is typical to see both companies mirror each other in terms of their action.

Big ICT players specifically MNOs in the EAC region are characterized by complex buffet pricing and bundled products. For example, prices reflected by average revenue per user (ARPU) in telecoms, have dropped over the years, however, this could be explained by the ability of competitors to replicate product offerings.

Competitive conduct would quickly change if the number of incumbents increases as shown by a study of Bresnahan and Reiss (1991). Using data on geographically isolated monopolies, duopolies, and oligopolies, they analyze the relationship between the number of firms in a market, market size, and competition.

a) Pricing and product offering

The pricing and product offerings in different industries across the region directionally are similar, despite the many and at times complex buffet pricing and bundled products they offer. For example In Kenya, the response to Safaricom Pricing by competitors will be fairly similar to the one of Airtel Uganda and its competitors.

Despite the fairly competitive pricing in some markets, industry costs such as service access costs remain relatively high, serving as a barrier to usage. As per Tirole (1993), the observation of a market price speaks little about the competitiveness of the corresponding industry unless one can observe prices in industries with similar cost structures (for instance, different geographical markets), or can observe a temporal pattern of the industry price or can accurately measure firm's marginal costs.

Companies have from time to time continually come up with new tariff plans to attract more customers and maintain a client base (Cayanan & Suan, 2012). Economists call this practice "price-discrimination" in order to take advantage of differing demand elasticities among customer segments. Any differential pricing scheme can be viewed as unfair, even if it makes customers, as a whole better off.

A bundle can be designed to suit the consumer's budget, lifestyle, and needs. The effects of price discrimination on consumer welfare can either be positive or negative, depending on the market and on the differentiation scheme. If the price discrimination scheme does not increase supply, it cannot increase total consumer surplus.

b) Customer Retention

In the ICT industry, companies have to contend with churn, especially in telecom services. Several factors influence churn, some more uncontrollable (regulatory or technological) than others (demographics, purchase history, customer experience, business, and environmental factors).

As such, churn is a possible indicator of customer dissatisfaction, cheaper and/or better offers from the competition, more successful sales and/or marketing by the competition, or reasons having to do with the customer life cycle. Whatever the drivers are, the actions of the companies in retaining customers will ultimately impact their revenue and margin performance.

As such companies can,

- ✓ Subsidize and discount products and services.
- ✓ Reward customers, for example, extra months of viewership common in the Broadcast markets.
- ✓ Converged offers, such as bundled voice, data, cable, and other triple-play services.

c) Innovation

The ICT sector is very innovative by its dynamic nature. Innovation in tariff structures could be a route for anti-competitive behavior in which inputs at the vertical layer or downstream present opportunities for incumbents to restrict other players.

d) Mergers and acquisitions

One of the most contested practices globally is the ability of NRAs to manage mergers and acquisitions as well as the ability to free up their economies from monopolistic tendencies. The EAC ICT sector has evolved since the early 2000s at the advent of privatization. A host of players have therefore come into play and grown over time.

As such, most of these companies enter under-table dealings commonly hidden under bilateral agreements or the charade of mergers and acquisitions, commonly known as collusion.

Collusion is a non-competitive, secret, and sometimes illegal agreement between rivals that attempts to disrupt the market's equilibrium. The act of collusion involves people or companies which would typically compete against one another, but who conspire to work together to gain an unfair market advantage.

4. Performance

Performance refers to the outcome resulting from the current market structure and conduct of industry players. Key indicators of performance include,

1. Revenue growth
2. EBITDA margins
3. Return on Equity
4. ROA over time.

For market performance, many economists also measure market power using the Lerner index, which is the percentage markup of price over marginal cost. Because marginal cost measures are rarely available, many SCP researchers use the price–average variable cost (AVC), which is typically calculated as revenue minus payroll minus material cost divided by revenue (Perloff, Karp, & Golan, 2007).

The extent to which a firm can benefit from the industry's monopolistic or oligopolistic condition is dependent as well on the flexibility of its demand curve. The Lerner index will be between 0 and 1; the closer it is to 0, the closer it is to perfect competition; the closer it is to 1, the higher market power the seller has and hence closer to a monopoly.

6.0 ESTABLISH REGULATORY REMEDIES

After one has conducted the SCP approach to identify competition issues, NRAs usually devise means to counter anti competitiveness.

Regulators are becoming increasingly concerned about rises in market power and the growing influence of the larger industry players in telecoms, post and courier, broadcast, multimedia as well as telecom operators.

These concerns include economic aspects such as whether these companies are purposefully moving to prevent competition, as well as data privacy issues, but also issues related to politics, the control of the media, and even the democratic process itself. At the same time, competition law enforcement is perceived as less effective in solving competition concerns, and this has spurred a debate about how and whether to regulate, and proposals to intervene with ex-ante regulation have multiplied.

As such there are many ways in which NRAs worldwide address competition concerns. This is through Ex ante and Ex Post regulation.

a) Ex-ante Regulation Measures

   The ex-ante regulatory framework has a preventive objective: interventions are implemented.

   When specific economic and market characteristics require so, with the aim of promoting competition towards an open and competitive market. This is justified for instance in markets tending to be highly concentrated, or when private actors can exert a significant market power or enjoy exclusive control over a gateway.

   Ex-ante regulation is thus implemented before and independently of an actual abusive behavior with the aim to minimize the market players' incentive and ability to engage in such practices given their potentially irreversible effects on competition, innovation and users' freedom of choice.

   i. Ex Ante Tariff Assessment Frameworks
   ii. Standards on Pricing and Rate Cards

b) Ex Post Regulation Measures

Ex post-regulation is a remedial regulatory mechanism that caters to counter an anti-competitive practice that has already occurred. Over the years especially in the European and North American ICT markets, this has been the most visible.

Some of the prominent measures used in this remedy include,

i. Denial of Mergers and Acquisitions
ii. Fines and Penalties in the case of anti competitive conduct
iii. Establishment of Metering and Billing Frameworks