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Equitel: The Battle for Mobile Money in Kenya

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"Kenyans are hungry for choice. The move will not only provide a chance to compete on equal grounds but also allow for innovation."

Adil El Youssetta, Airtel Kenya managing director

By 2014, the Kenyan telecommunications sector was one of the most dynamic in Africa. With mobile penetration rates hitting 80%, telecom companies offered almost every Kenyan not just voice and data communication but money transfer and microfinancing services via their mobile phones. Most prominent among these services was M-PESA, the pioneering money-transfer service launched in 2007 by Safaricom—the country's largest and homegrown operator. M-PESA made Kenya world-famous for its innovative use of mobile banking technology.

In a new twist, in April 2014, the Communications Authority of Kenya (CAK) announced that they were opening the sector to mobile virtual network operators (MVNOs). MVNOs could provide voice, SMS, data, and money services using the infrastructure of existing mobile network operators without needing to invest heavily in new mobile infrastructure. The CAK was eager to open the market to MVNOs in order to put an end to the dominant position of Safaricom and M-PESA and promote the entry of new players that would provide new value-added services.

Equity Bank—the largest retail bank in the country—was considering requesting an MVNO license to run the new Equitel services, which would include voice, data, and a full range of mobile banking services backed by Equity's existing banking network. The potential entry of such an important new player had provoked a significant strategic debate. What would Equity's strategy consist of regarding Equitel? Could it challenge Safaricom's dominance? How would Safaricom react? Would opening the door to MVNOs like Equitel be enough to stir up competition or should the regulator consider more actions?

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The Telecommunications Industry in Kenya as of 2014

Mobile telecommunications in Kenya, much like in the rest of Africa, had seen strong growth to leapfrog the absence of fixed-line services. By March 2014, mobile subscriptions in Kenya had reached 31.8 million (a 78.2% penetration rate). Mobile growth had been spurred by the liberalization of the sector and the introduction of a second-generation global system for mobile communications (GSM) in 2000 and third-generation (3G) in 2008. The competitive landscape consisted of the following four mobile network operators: Safaricom Ltd (67.8%), Airtel Kenya (16.5%), YuMobile/Essar Telecom (8.0%), and Orange/Telkom (7.7%) (See Exhibit 1 for Kenya main country indicators and Exhibit 2 for market share evolution of each player).

Safaricom started as a state-owned company but in 2014, 40% was owned by Vodafone[1] and 25% by the government of Kenya; the remaining 25% was publicly traded.[2] That year, company revenues were 144.67 billion Kenyan shillings ($1.66 billion[3]) with a subscriber base of 21.56 million. The company's market share had dropped significantly from 80% at the start of 2009 to less than 70% in recent years. Company revenues had also gradually shifted, with voice services slowly declining and being replaced by data, SMS, and mobile money services (M-PESA). Safaricom's dominant position was due to several success factors: a large customer base that facilitated network connectivity, the largest network of distributors and resellers in the country and—very importantly—the success of M-PESA, which created a barrier to entry for competitors (see below: "M-PESA and the Mobile Money Market in Kenya"). The company had also played a dominant role in the marketing arena, positioning the Safaricom brand ubiquitously as truly Kenyan—and Kenyan-owned—in comparison with its foreign competitors. Although the company had higher fees than its competitors, being a Safaricom customer had become almost an emotional matter.[4]

Airtel Kenya was a subsidiary of India's Bharti Airtel Ltd.[5] Airtel's situation in Kenya was especially difficult, with revenues of only $161 million and estimated losses of $75 million in the 2014 financial year. Its customer base had stagnated at around five million customers. As a result, part of Airtel's network was largely underutilized (usage of around 40% at peak time and 10% to 20% during the rest of the day.) The company had tried to appeal to the rational consumer by offering lower rates than Safaricom, emphasizing quality network coverage and productivity-based solutions for business individuals and large and medium-sized companies.

The other two players were YuMobile and Orange. YuMobile was part of the Indian Essar Group.[6] It had more than 2.5 million mobile subscribers (8% market share) as of 2014. The company was always perceived as a low-cost, low-service provider aimed mainly at young and low-income

[1] Vodafone was the world's secnd-largest mobile telecommunications company at that time. Vodafone's operations in Africa were divided into Vodacom (with operations in five countries: South Africa, the Democratic Republic of Congo, Lesotho, Mozambique, and Tanzania), in which the U.K. company held about 65%, and Vodafone-branded businesses in Egypt and Ghana.

[2] In March 2008, in the largest IPO in Kenyan history, the state sold 25% of its previously 60% participation.

[3] As of May 1, 2014, the exchange rate was $0.0115 to 1 Kenyan shilling and 87 Kenyan shillings to $1.

[4] The company was Kenya's most admired brand, with an overall equity score of 85% and a Kenyan resonance score of 94%, according to research commissioned by Safaricom (See *Safaricom Limited FY14 Presentation*.)

[5] Bharti was the world's third-largest telecommunications company in terms of the number of subscribers, with operations in India, Bangladesh, Sri Lanka, and 17 African countries. It entered the African market in 2010 when it acquired Kuwait-based Zain Telecom's African business for $10.7 billion. As of March 2013, Airtel had 63.4 million subscribers in 17 African countries (as compared to their initial forecast of 100 million), with revenues of $3.76 billion and a net loss of $345 million.

[6] The Essar Group was a $39 billion Indian multinational corporation with 73,000 employees and investments in steel, energy, infrastructure, and services and operations in 29 countries. It entered the East African mobile market in 2007 with the Yu brand after buying Econet Wireless' Kenya business for $145 million.

consumers, despite having invested heavily in Kenya—about 48 billion Kenyan shillings ($550 million) as of 2014. Orange Kenya (previously state-owned Telkom Kenya) was 70% owned by the French company Orange Group, while 30% remained in the government's hands. In 2014, Orange had 2.4 million customers and revenues of 9.5 billion Kenyan shillings ($110 million), down from Telkom's 12 billion Kenyan shillings ($138 million) in 2006, and estimated losses of 9.1 billion Kenyan shillings ($105 million). Orange had focused on expanding mobile data services to large companies and small and medium-sized enterprises (SMEs) with only modest increases in customer base and revenues.

The competitive context was characterized by a stiff fight for market share, decreasing revenues per customer, rising operating costs, and costly technology investments. Exhibit 3 summarizes each company's customer and financial performance indicators.

From 2011, tariffs started to drop substantially as a result of the CAK's decision to cut interconnection rates (see Exhibit 4).[7] The price war was further exacerbated by the aggressive price-based entry of Bharti Airtel that same year. As of 2014, average revenue per user (ARPU) had fallen to below 400 Kenyan shillings ($4.60) and it was forecasted to keep declining in the coming years.

Network building and operating costs were significantly high as the regulator pushed companies to provide additional rural coverage and improve the quality of service. As of 2014, Kenya's four mobile operators had a combined network of more than 6,000 towers across the country. When compared with international benchmarks, this was grossly insufficient for the country's population and surface area. However, experts considered that, given the average Kenyan voice and data consumption, there was overcapacity (at least in the areas of the country where most of the population was concentrated). On the other hand, all mobile network operators were forced to actively invest in upgrading their technology to keep up with the competition. For example, Orange had spent an estimated 120 billion Kenyan shillings ($1.3 billion) in seven years. Estimates for future investments needed to run around $300 to $500 million for all operators together over the next three to five years.

In this tough context, only Safaricom was able to achieve satisfactory financial results. Both Airtel and Orange had persistently blamed Safaricom's dominant position for their own lack of competitiveness. Safaricom, on the other hand, argued that its privileged position was due to its innovations, technological leadership, and control of costs. The company claimed that tariffs in Kenya were among the lowest in Africa as proof of Safaricom's cost leadership in the industry.[8] However, the general opinion was that the authorities in Kenya sided easily with Safaricom since the government was in part owner and Kenyan citizens perceived the company as a national champion. Equally important was the fact that Safaricom was also a major contributor to the national budget, in the form of both corporate tax and value-added tax (VAT) levied over airtime and M-PESA transactions.

As a result, the future of the sector was unclear. The fourth competitor, YuMobile, was being dismantled and Orange had formally notified the government that it was in the middle of negotiations with potential buyers, among them the London-based private equity firm Helios

[7] The rate fell from 4.42 Kenyan shillings ($0.05) in June 2009 to 2.21 Kenyan shillings ($0.02) in July 2010 and 1.44 Kenyan shillings ($0.01) in 2012.

[8] Despite being relatively low, tariffs in Kenya were still around 4 cents per minute, compared with less than 1 cent per minute in India.