COMPETITION TRIBUNAL

REPUBLIC OF SOUTH AFRICA

Case Number: 10/LM/Nov99
and
Case Number: 13/LM/Nov99

In the large mergers between

Vodacom Pty Ltd and

GSM

and

Vodacom Pty Ltd and

Teljoy Holdings Ltd

Reasons for Competition Tribunal's Decision

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1. Approval

In September 1999 the Vodacom Group Pty Ltd, the cellular network operator, decided to acquire additional shares in two of its exclusive service providers in which it already had existing stakes. In brief we had to consider whether these mergers, whether assessed separately or together raised any competition concerns for the cellular communications industry. We have concluded that they do not and we have approved the mergers unconditionally.

The competition issues in both mergers are similar and for this reason we are dealing with them in the same decision.

2. Nature of the Transactions

GSM

In this transaction the several minority shareholders have offered their shareholdings for sale to Vodacom. The result of the transaction is that Vodacom will increase its shareholding in GSM from 50% to 100%.

Teljoy

In this transaction Vodacom has made an offer to purchase 100% of the shares in Teljoy Holdings Ltd. Currently it holds 25% of Teljoy Holdings.

3. Nature of the Businesses

Both GSM and Teljoy[1] through its subsidiary Teljoy Cellular Services Pty Ltd are service providers. To this end both firms have these services in common;

1) Selling contract airtime
2) Selling prepaid airtime
3) Renting cellular handsets
4) Selling cellular handsets and accessories

Vodacom is one of the two companies licenced to operate a national cellular telecommunications network. Vodacom in turn owns various subsidiaries one of which Vodac is its wholly owned service provider.

4. Nature of the mergers

The mergers are both horizontal and vertical in nature. They are horizontal in essence because they involve the consolidation under common control of two erstwhile competitors and secondly because Vodacom is already vertically integrated and owns Vodac the largest service provider for its network.

[1] Teljoy through some subsidiaries is also engaged in the television rental market .This market contains no competition concerns for us and is therefore not analysed.

They are also vertical in the sense that the acquirer Vodacom is further consolidating downstream.

5. Horizontal issues

An analysis of the issues requires a short history of the industry because changes in the fortunes of service providers have altered their competitive significance.

When the first cellular licences were issued to Vodacom and MTN the industry model that regulators hoped would result was one where vertical differentiation would take place between network provider and service provider. The concept of service provider was borrowed from the United Kingdom's experience where in the late eighties the regulator had required the networks to make use of independent service providers. Thus an industry of intermediaries was established between the consumer and network. Our regulators followed the UK model by wanting to encourage vertical differentiation in the industry between network and consumer. The rationale was that although the industry could only accommodate two networks who required a licence to enter the market, the next layer of the industry did not require regulation and it was hoped would become the subject of vigorous competition between service providers. Unlike the United Kingdom the use of service providers was not made compulsory and the licence conditions of Vodacom and MTN stipulate that they can provide these services themselves or appoint agents to do so on their behalf.[2]

Although many firms entered the market as service providers most have either merged or failed. The reduction in the number of service providers has not led to higher prices for consumers.

This is because firstly, tariffs offered to consumers are set by the networks and must be approved by Satra and secondly because the networks imposed standard contracts on the service providers who in turn passed these on without mutation to the consumer. Competition amongst service providers impacted on the consumer in relation to convenience and location and not much else. What rivalry there was benefited the network, in the same way as the competition amongst salespeople who peddle the same brand serves the interests of their employer more than their customer.

But the most important change that has led to the demise of the service provider is the change in the industry with the advent of pre-paid

[2] See Paragraph 14.1 of Government Notice no 1078 of 1993, Government Gazette no 15232 29/10/93.

subscribers. Prior to 1996 most cellular services were sold to consumers by way of a 12 month or 24 month contract with one of the networks.

Vodacom in their submissions to us have described the evolution of the service provider. When the industry was in its infancy the service providers in return for a commission on their contracts assumed the burden of concluding contracts, vetting credit worthiness and collecting revenues on behalf of the networks. Because they assumed the credit risk on the contracts many failed. Not surprisingly, as the market for cellular services has grown the need to avoid the risk of credit failure led to the advent of pre-paid services

Eighty five percent of Vodacom's new business is now pre-paid. Since pre-paid services eliminate the need for any one to contract with a consumer, to vet credit worthiness and to collect revenues, the traditional role of the service provider has diminished. Supermarkets, service station and spaza shops now sell the networks' products obviating the need for ISP's or for an extensive network of outlets for them.

The result of this is that the traditional service provider market no longer exists in its pure form and increasingly the downstream market is characterized by the role of retailers who aren't service providers. GSM and Teljoy are now involving themselves in what are described as "back office" operations namely the management of retailers or a wholesale to retailer relationship. The Commission regards this as the relevant market for the purpose of the merger. It is not necessary in our view to decide this issue, as even on the narrowest conception of the market, competition remains unaffected.

Even if Vodacom is to wholly integrate its service providers the effect on competition will be negligible[3]. The role of service providers is to provide the networks with a customer base. If the networks think they can do the job more efficiently they should be allowed to do so. This is consistent with the current view on the subject as expressed by Oftel[4] who state in their review of the mobile market dated July 1999,

> *"In a fully competitive market, there would be a presumption that if networks did not wish to use independent service providers as a route to market, then it would not be efficient for them to do so and regulatory intervention to require this would not only be inappropriate but counter- productive. This is consistent with*

[3] MTN has already integrated these services through its subsidiary M-Tel. A viable independent provider Autopage remains in the market.

[4] Oftel is the acronym for the Office of Telecommnications the United Kingdoms industry regulator.

standard competition analysis which makes no presumption against vertical integration.

6. Vertical Issues

Typically vertical mergers raise less competition concerns than horizontal ones and when they do so it is usually because they either increase the barriers to entry into a market by requiring competitor to vertically integrate as well thus raising rivals costs or because they force them to increase their costs and thus make them less competitive in the horizontal market in which they face the integrated firm. The subtext to all this is the imminent entry into the network market by an as yet unidentified third licensee. Satra has at the time of this decision conducted hearing into applications for a third licence but has yet to award the licence. If anyone were to be effected by foreclosure in the distribution markets it would be the third licencee. For this reason the Tribunal required the Commission to provide its recommendation to all the applicants for the third licence and invited them to make representations to the Commission concerning the mergers. Only one of the applicants, Cell C, accepted the invitation. They indicated that they were not opposed to the merger although they had long terms concerns about retail exclusivity, which we deal with below.

At first blush this silence from potential competitors in an industry noted for the vigor and sophistication in which players engage regulators, as part of their business strategy seems surprising. The Commission's investigators say their market information is that the third licence applicants do not want to go the ISP route as did the existing networks and hence the mergers raise no concerns for them. The Commission's report quotes one of the applicant's licence application's which says that they have found the traditional service provider model inadequate. The absence of concerns about vertical integration from those with the most interest in objecting is the most telling fact that the mergers raise no concerns about entry barriers. Nor indeed has Satra the sector regulator chosen to make any representations although invited to do so by the Commission.

A second reason the merger has not generated much controversy amongst Vodacom's competitors present and potential is that both GSM and Teljoy were exclusive suppliers of Vodacom's products and neither could take on a competing network without Vodacom's prior consent. Thus the merger does little to later Vodacom' s existing ability to foreclose access to its rivals. Further there is no evidence to suggest that this exclusive relationship has led to complaints in the past.

Vodacom motivates the mergers by efficiency gains that can be achieved through uniform IT systems and amortizing these costs over a wider

subscriber base. We have not examined these efficiency claims critically since they are not necessary to sustain our approval of the mergers since they raise no competition concerns. Their only relevance is to indicate that there is a legitimate business motive for these mergers which is not linked to the exclusion of rivals.

7. Future Concerns

The one area where competition is currently vigorous in the downstream market is at the level of the retailer.

Retailers have become an increasingly significant outlet of the networks products with the advent of pre-paid services. Retailers do not affect the price of service, which as we have stated is pre-determined by the network with the approval of the regulator, but they do compete for ancillary supplies such as the price of a handset.

There are indications that the incumbent networks may be moving to tie up retail outlets with exclusive supply contracts thus foreclosing those outlets to its rivals. Cell C in its submissions to us states,

> *The purchase of Service providers to facilitate vertical integration does not concern our client as much as the practice of limiting the number of distribution outlets through exclusivity agreements, either directly or through service providers of either of the operators. Both Vodacom and MTN appear to be engaging in these practices, which we believe are anti competitive, and warrant the attention of the Competition Commission.*

We view this trend with some concern because although its is trite that a multiplicity of retail outlets capable of supplying cellular network products exist the elimination of strategic outlets could substantially raise rivals costs in particularly the new entrant which will lack the market leverage to either attract retailers with similar offers or indeed to dissuade them from exclusive contracts with its more extensive rivals.

However the present mergers involving Vodacom's consolidation of two already supplicant service providers will not enhance its ability to impose exclusivity on its retailers as it derives that leverage not from its hold over service providers but its power in the network market which remains unaffected by this deal. As pointed out correctly by the Commission if these practices do become prevalent the correct approach would be to consider them as potential restrictive practices.

In conclusion we have decided to approve the mergers without conditions.

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N.M. Manoim **Date**

Presiding member

Concurring: D.H. Lewis and P.E. Maponya