ANOTHER FINE MESS FOR AFRICAN TELECOMS

A XALAM ANALYTICS MARKET BRIEF

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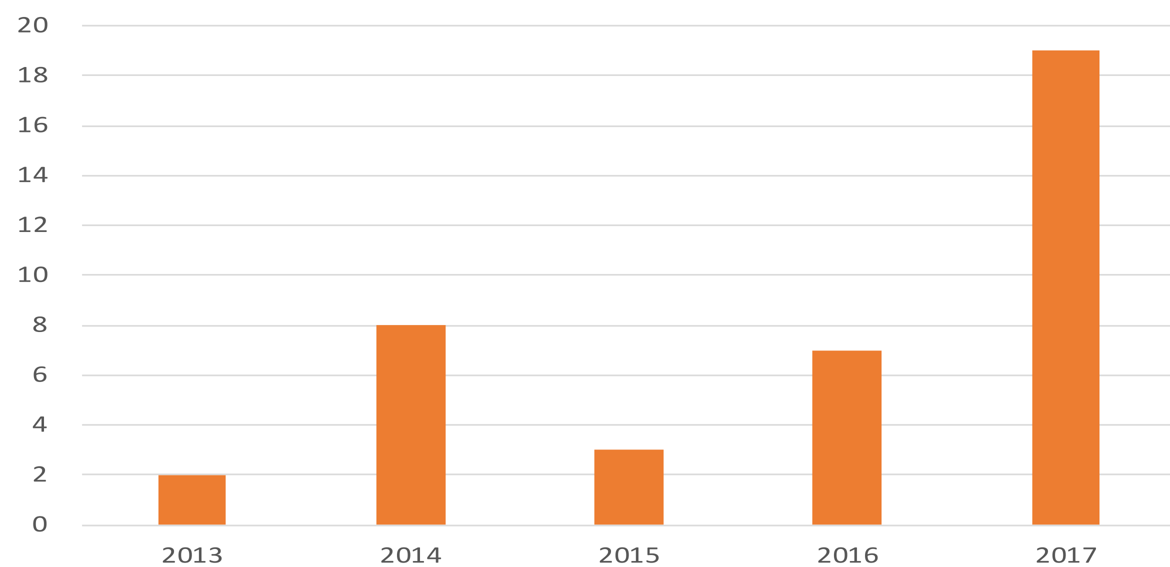
Fines imposed on African telecom operators are skyrocketing; what's driving this trend and what impact is it having?

African governments have found a new, potent weapon in their efforts to wring more cash out of the telecoms sector -- the regulatory fine. A Xalam Analytics review of around 50 procedures of sanctions against telecoms operators across 20 African markets over the 2011-2017 period shows that the number of fine procedures has skyrocketed across the continent.

2017 was a banner year, with the number of procedures tripling from 2016 levels, to nearly 20, with the number of fine citations nearly hitting the 50 mark. In terms of value -- and excluding Nigeria's imposition of a US$5.2 billion fine on MTN in 2015, an outlier -- regulatory fines and tax claims have averaged around $350 million per year during the past two years, more than ten times the annual average prior to 2015.

The analysis covers procedures engaged only -- not all fines are ultimately paid and some procedures are challenged in courts. 2018 is off to a flying start: In early to mid-January alone, new fines were announced against operators in Mauritania (a repeat offender) and Kenya, both for a variety of quality of service (QoS) and network coverage violations.

Number of Procedures of Sanction Against African Telecoms Operators



Based on analysis covering 20 markets in Africa; excluding state and local-level procedures in the Nigerian market.
Sources: Xalam Analytics Research

The analysis of fines and other government claims against African telecom operators shows several notable characteristics:

-- **Fines are assessed for an increasingly diverse set of reasons**: Between 2011 and 2015, 75% of procedures were related to quality of service (QoS) and network coverage violations; nearly 60% of fine value was tied to QoS (excluding Nigeria's $5.2 billion fine). During the 2016-17 period, QoS accounted for about half of the procedures but less than 10% of fine value, with unpaid taxes and fees driving most of the potential proceeds.

-- **The fines are getting costlier in absolute terms**: In 2017, the average value of a fine was around $6.5 million, down from nearly $20 million in 2016, though the median fine value is still relatively small, at less than $1 million.

-- **Nearly 60% of procedures against telecoms operators take place in West Africa**: Regulators in French-speaking Africa are especially sanction-prone -- nearly 70% of the procedures are started in those markets.

-- **MTN and Airtel are popular targets**: By our estimates, Airtel's African operations have been the most targeted by government procedures, slightly ahead of MTN's. In terms of fine value, MTN is the largest target of African telco fines -- even excluding the $5.2 billion Nigeria fine, African governments have asked MTN operations to pay around $400 million in various forms of sanctions and fees since 2014, an average of around $100 million each year.

THE NIGERIA PRECEDENT, AND MAKING UP FOR LOST REVENUE

Regulatory fines are not a new phenomenon in the African telecoms sector. So why the sharp increase in procedures? The answer is multi-formed:

-- **The Nigeria precedent:** Most trends have a seminal event, and as far as sanctions against African telecoms operators go, Nigeria's 2015 fining of MTN for SIM registration violations was foundational. The MTN fine was not only stunning for its scale -- around 120% of the company's revenue at the time it was levied -- it also showed that regulatory sanctions could be an extremely effective source of additional government revenue. Governments have also realized that it is difficult for telcos to adhere to the letter of their licences, the parameters of fining can be flexible, and the broader public is highly supportive.

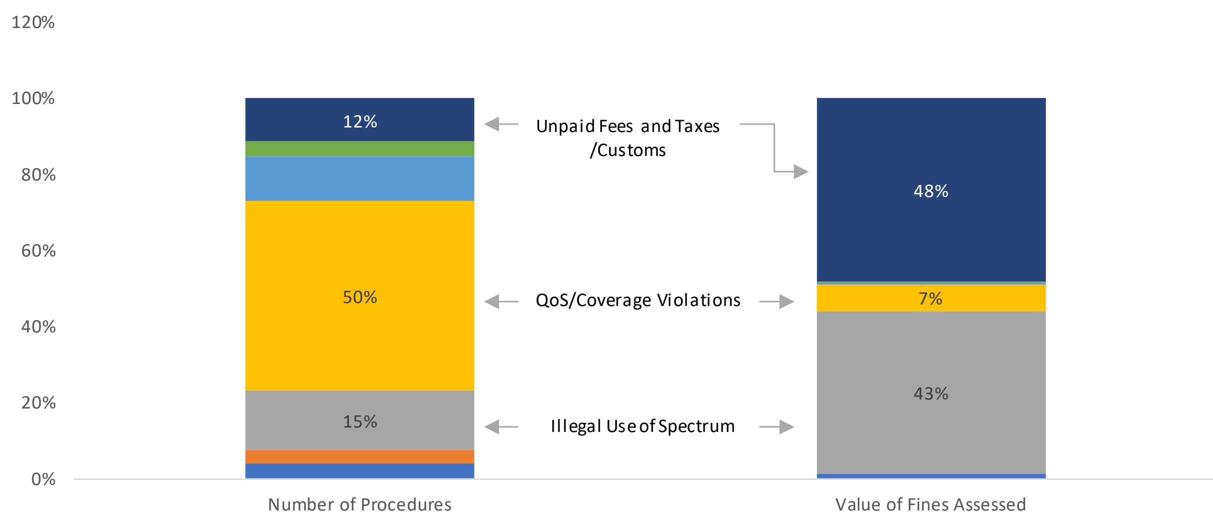
In effect, the MTN fine put substantial pressure on many African regulators to do the same, lest they be accused of complacency, or complicity with telecoms operators. In many markets, the ability to levy sanctions against telcos is increasingly regarded as a key feature of regulatory effectiveness. He who does not fine is probably not trying; in turn, most regulators have rushed to acquire equipment to monitor QoS, and nearly all now run continuous QoS monitoring programmes.

-- **The need to make up for lost revenue:** The telecoms boom has made the sector something of a cash-cow for African governments. Between licence, spectrum and a wide assortment of taxes and fees, telecoms operators have become some of the largest individual contributors to national budgets, accounting for between 5% and 15% of tax income. Lately, however, the cow has been sputtering: In the 10 markets with the largest telecoms fines over the past five years, top line revenue growth has slowed, averaging 3%-6% during the past three years in local currency terms, down from double-digits between 2010 and 2014. In US dollar terms, top line revenue has contracted in many markets.

New sources of revenue (e.g. mobile money) have been more complicated to understand and tax. International incoming traffic, a critical source of government cash and foreign exchange, has plummeted under the impact of Internet Over the Top (OTT) players. In response, governments have chased other sources of revenue, hiking spectrum licence fees, introducing new or higher taxes, such as the hike recently imposed on operators in Chad (from 7% of revenues to 9%), and actioning the regulatory fine lever with renewed intensity.

-- **Deteriorating QoS**: it would be unfair to say that the only motivation of regulators is to raise revenue for their exchequer. African mobile network QoS issues are real, to be sure. Regulator data and anecdotal evidence suggest that QoS issues may be getting worse, and in many markets, public frustration with mobile operators has been spiking. Traditionally, mobile operators would merely ignore regulatory admonitions to solve QoS challenges or make perfunctory efforts to address them; in response, many regulators have increased the thresholds of QoS-related fines, from ~0.5%-1% of revenue to as much as 10% of revenue in some countries.

How African Telecom Fines Break down: Number of Procedures vs. Fine Value



Based on analysis covering 20 markets in Africa; excluding state and local-level procedures in the Nigerian market. Data covering the 2011-17 period. The chart excludes the $5.2bn levied against MTN Nigeria in 2015 for SIM registration violations, as it is a significant value outlier.
Source: Xalam Analytics Research

DO THE (QOS) MATH

For operators, managing fines for QoS is now largely down to mathematics. Network QoS and coverage are largely capex-driven, but as operating conditions have deteriorated, so has the return on capital invested. In effect, an additional dollar of capital in expanding coverage beyond existing levels is now more likely to carry a negative return (though the equation is different in congested urban areas, where most of the network capex still goes). In turn, more operators have been cutting capital expenditure levels; in several of the most sanction-prone markets, mobile network capital expenditure has declined by as much as 50% from 2013 levels.

The multiplication of regulatory fines has thus given way to a pernicious cycle, where everybody appears to win at some level, except for the consumer, who is a casualty of bad QoS in the first place. To win (or retain) their operating licences, operators agree to stringent coverage and QoS requirements, which they fail to meet as investment returns decline and sources of capital dry up. As their capex declines, QoS deteriorates, leading to regulatory fines. The government gets a new source of cash, the operator pays the fine but loses less money than it otherwise would, and QoS issues persist.

THE FINES ARE HERE TO STAY -- BUT THEY COULD YET BE USED MORE PRODUCTIVELY

For operators, the sharp rise in the volume of fines is another sign of an increasingly difficult operating environment. Fines are merely an outgrowth of a more structural deterioration of African market fundamentals -- and they are here to stay. In turn, operators have to adapt; they can establish internal alert systems to mitigate regulatory issues before they emerge, or provision 2%-5% of their annual revenue to paying fines. Should they do the math further, they may even see some net gains from allocating that 2%-5% provision to capex; this would make their networks better, reduce at least some of the fines and even provide a source of competitive advantage.

For regulators, this is a more difficult equation. The fine is a convenient, and increasingly popular option, but it’s an ineffective fix for the issues it claims to resolve. Assuming they are truly interested in resolving QoS issues, an option would be for regulators to *increase* the fines -- but reallocate proceeds from fines to network expenditures in areas that need it the most.

In effect, the government would take cash from the income statement and reallocate it to capital investment. The consumer would benefit from better QoS, the operator would invest more, but retain control of the asset (and potentially increase revenue as usage increases), and the government would get its cash in a more sustainable manner -- certainly more productively than the relentless fining of some of its best taxpayers.

Whatever the case, the pernicious cycle of telecoms fining is not sustainable over the long term. Governments that see fines as another way to milk the telecoms cow will merely drive more operators out of their markets.

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