Chapter 1: Orientation

1.1 Introduction

Price, product, place and promotion, collectively referred to as the marketing mix, are a set of controllable tactical marketing tools that are blended to produce the response required from a target market (Kotler and Armstrong 2004). Price is the only element of the marketing mix that represents revenue and is the most flexible of the four elements whilst the rest of the elements represent costs. With the correct blend of the other elements of the marketing mix, the pricing policy can be used as a tool to increase market share, create critical mass, maximise profitability, position products and also to create barrier for entry (Perreault & McCarthy, 2005).

The pricing policies of organisations exist to support the organisational objectives and therefore the management of pricing policy requires careful attention because it can determine the success or failure of the organisation in achieving the desired objectives. Also influencing the pricing policies of the organisations is the market environment within which the organisation operates. Pasura and Ryals (2005) found in their research that the information and communication technology (ICT) sector pricing policies are still very much driven by the cost recovery and profit objectives as well as competitor pricing. The ICT sector comprises of value added network services providers, fixed-line telecommunications, information technology and mobile telecommunication services.
Telkom has not been an exclusion to the above factors except that Telkom’s pricing policies are yet to be affected by competition due to the limited competition in the fixed-line business currently. Telkom has enjoyed protection from competition by the fixed-line licence that allowed Telkom to be the exclusive provider of fixed-line telecommunications services up to 2002. The government only licensed the second network operator in the form of Neotel late in 2004 and is yet to be fully operational.

From the period of exclusivity to the current period of limited competition, how has Telkom managed its pricing policies in order to exploit the current opportunities whilst also preparing for the future changes in the market? This research will study the existing theory and latest literature on the subject of pricing policies, pricing objectives as well as the respective effects on the market and evaluate Telkom’s management of the pricing policies against the theory and literature.

1.2 About Telkom

Telkom was formed in 1991 as a government fully owned entity providing telecommunications services which were previously provided by the Department of Post and Telecommunication of South Africa. In 1997 the government sold a 30% equity interest in Telkom to Thintana Communications LLC as part of privatisation process and included in the agreement was the exclusivity licence for Telkom to be the sole provider of
fixed-line telecommunication services for a period of 5 years up to 2002. Thintana sold off their shareholding at the end of exclusivity in 2002. In 2003 Telkom listed on the Johannesburg Stock Exchange (JSE) and New York Stock Exchange (NYSE).

Exclusivity periods have in most researches undertaken, been found to result to price increases, decrease in infrastructure investments, poor customer service and also being anti-competitive in their proneness to cross-subsidise which are all in direct contrast to the intended consequences (Wallsten 2004 and Parsons 1998). In his state of the nation address in 2007, the president of the country, Mr Thabo Mbeki reiterated the sentiment that telecom prices are still high in South Africa.

In a price sensitive market like ICT, changes in price would significantly affect demand more than the quality of the service provided by the competitors (Demirhan, Jacob and Raghunathan, 2006). As part of the strategy to lower telecommunications costs in the South Africa, the government licensed Neotel in 2004 to be the second network operator to compete with Telkom and also further licensed value added network service providers (VANs) to transmit voice calls over the internet protocol which has previously been illegal under the Telecommunications act 103 of 1996.
1.3 Research objectives

Contrary to the general perceptions, (Kotler & Armstrong, 2004) argue that monopoly does not necessarily equate to high prices because the firm has to make a choice between higher price and demand. Moreover higher price would attract new entrants into the market even though this is limited in the telecommunications market through regulation. However the price-cap regulation established under the Telecommunications Act 103 of 1996 has been introduced with the intention to ensure reasonable tariff adjustments as well as to ensure that inefficiencies are not passed on to customers in the form of higher prices (Loube, 2001).

The purpose of the study is:

• to understand the relevance and nature of the pricing policies that have been adopted by the incumbent fixed-line operator Telkom.
• to critically evaluate the management of the pricing policies in the periods of changes in the market landscape more especially within the context of regulation and the imminent competition from VANS and Neotel.
• to research the impact of Telkom’s pricing policy decisions on its business.
• to research literature and theory relating to the management of pricing policies and to identify possible gaps as well as provide recommendations.
1.4 Definition and clarification of terms

**Access deficit**: Fixed-line telecommunication specific term referring to the negative difference between the subscription tariff and the cost of providing the voice access line.

**Exclusivity period**: Period during which an organisation is allowed to operate without competition.

**Organisation/company/firm**: These words are used interchangeably and have the same meaning in this document unless specified to be different.

**Price-cap regulation**: A regulation that limits the rate of price increases based on an established formula that usually includes a productivity factor.

**Products/service**: These words are used interchangeably in this research to have same meaning unless specified to be different.

1.5 Abbreviations

**ADSL**: Asynchronous Digital Subscriber Line

**EBIT**: Earnings Before Interest and Tax

**ICASA**: Independent Communications Authority of South Africa

**ICT**: Information Communications and Technology

**PSTS**: Public Switched Telephony Service

**SNO**: Second Network Operator

**VoIP**: Voice over internet protocol

**VANS**: Value Added Network service providers
1.6 Delimitation of the study
The information contained in this research is limited by the current South African telecommunications market that consists of only one fixed-line operator. Neotel has been licensed but not fully operational yet in the retail markets. Furthermore due to the lack of access to the pricing policy documents of Telkom, publicly available information has been used to generate a view on pricing policy information.

1.7 Importance of the study
Telkom’s experience through the many changes the organisation has gone through and how it has managed its pricing policies under different market conditions will prove useful to the new entrants in ensuring the success in the fixed-line telecommunication market.

Neotel has not yet tested the market and the possible reactions to the way it is to position itself. This research would assist in providing insight into the best ways to manage pricing policies throughout product lifecycle of the fixed-line telecommunications services within the South African context. This would even be more useful in the light of the market environment within which fixed-line operators do business considering the competitiveness of the environment. Developing countries that are still to deregulate telecommunications industry could also learn to manage the expectations and put measures in place where necessary.
1.7 **Outline of the research report**

This research is divided into six chapters.

Chapter 1 is orientation and introduces a broad overview of the research, the objectives, delimitations, and the importance of the study.

Chapter 2 deals with the theoretical foundation of the study with more focus on factors influencing pricing policies including pricing objectives, pricing strategies, price-cap regulations as well as cross subsidisation.

Chapter 3 reviews the literature on related previous studies and the changing landscape of the South African ICT sector.

Chapter 4 deals with the research methodology and the relevant literature.

Chapter 5 presents the research results.

Chapter 6 summarises the findings, makes recommendations and draws conclusion.
Chapter 2: Theoretical foundation of the study

2.1 Overview

This chapter will look into the theoretical texts on factors that influence pricing policies. In this chapter pricing objectives, pricing strategies and price-cap regulation are discussed as factors influencing pricing policies. Monopoly markets could, due to lack of choice for the customers, result in inefficiency costs being passed on to customers. Therefore these inefficiencies could have a significant influence on pricing policies hence cross subsidisation is also discussed in this chapter. The purpose of exploring these theories is to relate them to the practical application in the management of pricing policies within Telkom.

2.2 Introduction

In a free market economic system, prices are determined by the market laws of demand and supply. Price adjustments become a rationing mechanism to a point where over a period of time, the quantity supplied equals quantity demanded. This point of demand and supply equality is referred to as equilibrium point and changes to price will determine the quantities of demand and supply for the product or service. This theory however is true where market systems are perfectly competitive and all businesses have an objective of profit maximisation (Case & Fair, 2004). Therefore the basis on which the prices are set could determine the
demand, supply, the amount of profit, market share as well as the term within which the organisation may achieve its objectives.

These organisational objectives, the market environment as well as regulations in the case of fixed-line telecommunications in South Africa have an influence not only in the pricing policies but also in how these pricing policies are managed. As a result of these complexities, organisations set-up not just a single price but rather a price structure that covers their different products changing it over time as products move through life cycles (Kotler & Armstrong, 2004).

2.3 Pricing Objectives

Organisational objectives guide functional divisions in their search and evaluation of opportunities and later plan their functional strategies. The functional objectives should be set within the framework of broader company objectives. Marketing, finance, human resources and production are all examples of functional divisions. The marketing strategy needs to have objectives for each of the marketing mix variables i.e. product, promotion, place and price objectives (Perreault & McCarthy, 2005). Profit orientated, sales volume orientated and status quo orientated are the three broad categories of pricing objectives identified by (Perreault et al, 2005).

These categories are discussed below.
- **Profit orientated**

Organisations may have a specified target return on the investments and therefore prices for the products and services will be set based on a predetermined required rate of return. For an example the most widely used measure of performance in the telecommunications sector is the earnings before interest and tax (EBIT) margin as a percentage of revenue. A telecommunications company with a target of 30% EBIT margin will therefore price its services accordingly in order to achieve that set target.

Fixed costs remain constant regardless of the changes to the level of activity whilst variable costs change in direct proportion to the changes in the level of activity. Therefore profit maximisation pricing objectives do not necessarily result to higher prices because lower prices could increase demand leading to higher profits. Fixed-line operators for an example have network maintenance costs as fixed costs whilst call costs are variable. The higher the number of calls, the more the operator recovers fixed costs and the contribution margin (i.e. the favourable difference between selling price and variable cost) of each call contributes to profitability.

Companies that offer critical public services might pursue only satisfactory long-run financial targets because they are expected to set
prices that are in the public interest such that their prices do not prevent or become a barrier to the access of the organisation’s services. Pasura and Ryals (2005) research found that most of the organisations in the ICT sector are still using the cost based approach mainly to recover costs. A contributing factor could be the ease of calculating a price if a cost plus mark-up calculation is used.

- **Sales volume orientated**

Objectives to achieve a certain level of market share whether it be unit sales or sales amount without necessarily referring to profits are said to be sales orientated. Sales growth should be pursued but not to the exclusion of profitability because in the long run it could be detrimental to the financial well-being of the organisation. Market share objectives could assist in improving economies of scale but are usually accompanied by short term sacrifice of profitability with the hope that the higher volumes in the future will compensate for earlier lower profits. An organisation may however pursue sales orientated objective and sacrifice profitability in one product with the aim of selling complementary products that are more profitable. For an example Telkom may provide voice fixed-line access at cost with the aim of increasing the number of voice access lines that will in turn generate usage based revenue which could be more profitable.
- **Status quo orientated**

  In markets that have reached maturity levels and are thus not growing, the status quo pricing objective is most prevalent. Companies compete on other variables of the marketing mix but not on price. Mobile phone operators in South Africa have almost similar prices and they compete on value proposition and quality of service. Alternatively the strategy may be to price for the market share and constantly review the prices in line with the market share (Oh and Lucas 2006). Organisations whose main goal is to sustain a certain level of market share are most likely to adopt this strategy. It is most effective in highly competitive market environments.

2.4 **Pricing strategies**

Pricing objectives influence the pricing policies and therefore should be explicitly stated (Perreault & McCarthy, 2005). Pricing policy refer to the basis on which prices are set whilst pricing strategy refers to the manner in which the prices are set to achieve organisational objectives. There is in overlap between pricing policy and pricing strategy. Kotler and Armstrong (2005) differentiate between new-product pricing strategies, product mix pricing strategies and price adjustment strategy.
- **New product pricing strategy**

The two broad strategies that may be adopted by organisations for new products are market-skimming pricing as well as market-penetration strategy. Market-skimming pricing strategy refers to practice of setting high prices for new products targeting the top end of the market before aiming for the more price sensitive customers. It is generally safer to start with higher prices and then reduce them if and when necessary. As the price is being gradually reduced, the size of the market also expands resulting to more volumes. For market-skimming pricing strategy to be effective the value and quality of the product must justify its high price and also there must be enough buyers willing to pay a high price. The potential downside of this strategy is the ability of competitors to enter the market and undercut the incumbent’s high price.

An alternative strategy is that of market penetration pricing. The price is set low so that it may attract volumes. This strategy is attractive for large volume sales but for it to work, the market must be sensitive to price and there must also be benefits of economies of scale through higher volumes. Furthermore the lower price must be low enough to keep out competition.
- **Product mix pricing strategy**

Companies that sell different products that are related may decide to find the set of prices that would maximise profits. This strategy is complex because of different volumes, demand, price elasticity, costs and competition for each of the products. It is also this strategy that has resulted to much claims of cross-subsidisation which is discussed later in this chapter.

Captive-product pricing strategy involves selling the main product at a low margin price but command higher margins on products that must be used with the main product. Long distance calls for an example could be priced at a much higher margin than fixed-line access rental subscription. The company’s profitability in this instance is mainly from long distance traffic and not fixed-line access rental revenue.

Product bundle pricing refers to combining two or more products and selling them as a bundle at a reduced price. The strategy is more useful in improving sales of products that the customers would not normally buy. This strategy may have limitations in application within Telkom due to regulations that prohibit bundling of products that only Telkom specifically has a licence to provide with the competitive products. Pasura and Ryals (2005) argue that value based pricing is the most effective in the profit potential more than any other pricing approach.
- **Price adjustment strategy**

  This is a price differentiation strategy to account for customer and situational differences. A business customer may for an example attract higher discount than a residential customers because of the amount of business that is done with the company. Price structures are built around basic list prices and this strategy deals about altering these structures to the benefit of both the business and customers. Included in this strategy is discounting, segmented pricing, psychological pricing, promotional pricing, geographical pricing as well as international pricing.

- **Low cost provider pricing strategy**

  One of the most common pricing strategies is that of becoming the price leader in the market. With this strategy the business endeavours to be the lowest cost-provider among similar businesses. This strategy works well in market environments where there is little or no service differentiation between various service providers (Grant 2005) and the costs of switching from one service to the other are lower. For an example, number portability which makes it possible for customers to switch from one operator to the other without necessarily losing their numbers would facilitate this strategy of being a price leader or low cost provider. However in pursuit of this strategy most telecommunication organisations, more especially market dominant operators, become
subjects of allegations of pricing below costs commonly referred to as predatory pricing. Predatory pricing is an anti-competitive act of pricing low in order to drive out weaker competition so that once competitors have left the market, the organisation may charge higher prices and therefore increase profits (Hill, 2005). This strategy works mostly when the organisation has dominance in other markets where it can charge higher prices to cross-subsidise the other market. Telkom has recently been taken to the competition commission on allegations of predatory pricing and margin squeeze by rival service providers.

- **Value based pricing strategy**

(Perreault & McCarthy, 2005) define value pricing as setting a fair price level for a marketing mix that really gives the target market superior customer value. The strategy is a combination of the above pricing strategies to impact on customer value. Value-pricing is an externally orientated approach with the focus mostly being the value to the customer. The principle behind it is that prices should be set based on the value being provided to the users (Ge 2002). This pricing strategy has been found to be the most effective and attractive in terms of profit potential if the organisation finds one that works. A calling plan package of 1000 minutes and line rental at a fixed amount of R300 per month is an example of value based pricing. The perceived value to Telkom customers outweighs the price that has to be paid.
Most of the above pricing strategies ignore the reality of cost inputs into the pricing of products and services. Over a period of time, the purchasing power of the currencies, exchange rates where foreign trade is involved, changes in technology as well as the dynamics of the industry would result to changes in costs. Most organisations will avoid pricing below cost and mainly because businesses exist for profit and value creation and the price set for the products and services should recover the fixed and variable costs as discussed earlier in this chapter.

The historical costs of legacy systems also make it difficult for businesses in the ICT sector as technology and bandwidth costs are constantly becoming cheaper in real terms. This reality favours new entrants into the market as they enter the market at costs that are lower than those of the earlier entrants (Demirhan, Jacob and Raghunathan 2006). Pricing therefore has to be a well-thought long term strategy that evolves with the product in all its stages in the market.

Therefore in ideal conditions the most important determinant of the price should be what the customer is willing to pay for the service or product for the value proposition (Pasura and Ryals 2005). The users of the products and services of the organisation perceive value more in the presence of alternative or complementing products in the market.
2.5 Price-cap Regulation

Telecommunications infrastructure is viewed by economists and governments as one of the most important in ensuring sustained growth and economic development. In monopolistic and exclusivity based markets, governments have sought to control price increases through price-cap regulations in order to ensure that the companies operate efficiently and also to protect monopoly customers (Loube 1995).

The price-cap regulation for telecommunication services in South Africa is established under the Telecommunications Act 103 of 1996. The structure of price cap regulation prescribes the allowable tariff increase through a formula determined by the industry’s regulatory body. The Independent Communications Authority of South Africa (ICASA) is the communications industry regulatory body in South Africa and is responsible for the licensing of operators as well as monitoring and ensuring that the actual price index is within the basket limits.

The price cap formula includes the inflation measure as well as a productivity factor. ICASA determines what the productivity factor should be and that is subtracted from the inflation measure in order to determine the maximum allowable increase. For an example if inflation is 6% and the productivity factor is 3.5%, the overall price increase can thus not be higher than 2.5% (6%-3.5%). Because the fixed line telecommunications comprise
of multiple different services, the focus is on the overall price change meaning that within the basket of services, the prices could be higher than the overall price index. And for this reason there is also a limitation on the maximum increase for each individual service within the basket which is currently at inflation plus five percentage points.

The price cap regulation plays an important role in the formulation of pricing policies, determination of markets of interest as well as areas of profitability within organisations that are subject to the regulation. Management has to manoeuvre within these regulations as these regulations put limitations in the pricing policies that can be adopted by organisations in their pursuit of strategic market positioning. What is most important to note here is that the price cap regulation does not prevent the organisation from cross-subsidising among products within the basket of regulated services.

Most governments introduced price cap regulation in order to improve the efficiency of the state utilities and also to minimise/prevent the passing of any inefficiency costs to the users of the monopoly services. The price cap regulation has however not protected the users of the services but has instead allowed the companies to engage in cross-subsidisation (Loube 2001).
2.6 Cross-subsidisation

The term cross-subsidisation has been casually used in business to simply refer to the circumstances where contribution margins across products are not equivalent. This activity does not necessarily imply inefficiency nor is it anticompetitive (Parsons 1998). (Loube 2001) defines cross-subsidisation as support of one service by other services. For the purposes of this research cross-subsidisation refers to the spreading of cost of inefficiencies of one service to other products and services.

Parsons (2001) further identifies two tests to determine whether there is cross-subsidisation among the services or not. The first test is the incremental cost test which specifies that the subset of services is free from cross-subsidy if the revenue from any quantity of the subset of services is greater than or equal to the changes in total costs caused by not producing the subset of services. The second test is that of stand-alone cost test which requires that the revenue from the subset of services should be less or equal to the cost of providing the services independently.

Even though the tests subject is not pursued further in this research, it is clear from the above theories that cross-subsidisation is more about costs than prices and becomes more relevant in profit-orientated pricing objectives or where prices are set based on costs of providing the services but without incentives to improve efficiencies.
As mentioned in the paragraphs above, price cap regulation does not prevent cross-subsidization even though it is reduces the possibility of it (Loube, 2001). This aspect is discussed in detail in chapter 3 as part of the findings of previous studies.

2.7 Summary

Having discussed the pricing objectives, strategies, cross-subsidisation and price-cap regulation above as factors influencing the pricing policies, pricing policies can be said to be about utilising the price influence in order to achieve the organisational objectives. Management of the pricing policies is about how prices should be changed, for which products, at what intervals as well as transparency of the prices (Oh and Lucas 2006). The pricing policy can be used as a tool to increase market share, create critical mass, maximise profitability, position products and also to create barrier for entry (Perreault & McCarthy, 2005).

It is important also to note that the success of most of the pricing policies is dependent on the markets within which the organisations operate. Porter’s five forces model identifies five areas in assessing the competitive strengths of the strategy.

- Competitive pressures from rival organisations
- Threat or possibility of new entrants
- Availability of substitute products
• Buyers’ bargaining power

• Supplier bargaining power

All these factors have an impact on the pricing strategy and policies of the organisation. Pricing policies are informed by the strategic direction of the organisation with the major focus on the long term vision. Companies on the other hand have had to be creative in their pricing policies in order to ensure maximum profits, providing value for money and keeping customers satisfied whilst staying within the ambits of the regulations.
Chapter 3: Literature review

3.1 Overview
This chapter reviews the relevant literature to the study stemming from previous research that has been undertaken by various authors and also the impact of the changing landscape of the Information Communications and Technology sector (ICT) on the pricing policies and strategies.

3.2 Introduction
Chapter 2 discussed the theory behind the pricing policies and it is important to note that most of the theoretical analysis assumes that the market system is perfectly competitive. This assumption may not hold true in real-world markets. Imperfect competition is when a single firm has some control over price and potential competition (Case & Fair, 2004). Studies have been conducted previously by other researchers to determine the nature of pricing policies within these environments. This chapter reviews the findings of these previous research studies including the impact of exclusivity periods and cross-subsidisation.

3.3 Previous findings by other researchers
3.3.1 Pricing policy in European telecommunications markets
Kollman (2000) conducted a research study on the perspectives of a pricing policy in European telecommunications markets with the intention of demonstrating the correlation between the fixed connection charges and
usage based prices on one hand and the subscribers’ considerations that lead to the acceptance of the charges for using the services. The researcher argued that innovation management in telecommunications is a question of pricing and that the usage charges for telecommunications services mostly determine the commercial success of most network providers. The findings of the research were as follows:

- Business customers are mostly non-sensitive to price and may respond more to quality based strategy whilst private or residential customers are more sensitive to price and may tend to respond more to cost based strategy.

- The implications for pricing policies in telecommunications are that the relationship between fixed connection prices and usage charges determine the success in winning customers. A reduction in fixed connection price will ease the decision for potential customers to take up the services.

- Customer loyalty depends on the price structure of the usage charges and therefore care must be taken that prices are not increased to such an extent that they result to churn.

The research recommended that the managers of telecommunications service providers should focus on variable call charges and drop the idea of creating additional income through fixed monthly charges because these charges discourage customers from increasing the amount of usage.
3.3.2 Price-cap regulation impact on pricing policies

The research into the problems and solutions of the price-cap regulation was conducted by (Loube, 2001). The study was conducted in the United States of America (USA) with the purpose of determining whether the organisations operate efficiently under the price-cap regulation and whether the regulation provides an incentive to eliminate excess costs and capture windfall gains. The study research found that:

- The price-cap regulation allows monopoly organisations to engage in cross-subsidising price strategies because the regulation allows for selective price changes.
- Whenever the organisation operates in both regulated and unregulated markets, it has an incentive to transfer costs to the regulated market in order to justify its pricing strategy.
- The captive monopoly customers are not protected by the price-cap regulation due to the above two findings. For an example an organisation may add a maximum allowable increase on the price of a product on which it has monopoly power and add a small or no margin on the products that are in the unregulated market.
- The price-cap regulation does not establish a level playing field that would nurture the development of competitive markets. The cross-subsidising price strategies stifle competition.
3.3.3 The impact of exclusivity periods

Wallsten (2004) undertook a study to determine the real effects of privatisation transactions in telecommunications and how the exclusivity periods matter. The research was conducted by comparing the performance before and after the privatisation, across countries with different market structures. The researcher argues that precluding competition is likely to retard improvements in the telecommunications sector.

“The primary purpose of reform is to get consumers more, better, new, and less costly services. Pressures from interest groups—incumbents who want ongoing protection, new entrants seeking special deals, treasury officials expecting to use sales revenues to reduce budget deficits, financial advisers earning success fees tied to transaction prices—can steer reform off track. In particular, sales strategies that drive up prices paid for existing companies or new licenses can hold down growth, reduce the funding available to invest in those companies, or result in high tariffs” (Wallsten, 2004).

The research found that exclusivity periods increase firm’s sale prices but in turn lead to lower network investments, poor service and higher prices.
3.3.4 Cross-subsidisation in telecommunications

Parsons (1998) in his study of cross-subsidisation in telecommunications identified four areas of cross-subsidisation in the sector as found in the economics literature:

- Local versus long distance calls
- Business versus residential markets
- High usage versus low usage
- Urban versus rural

Parsons (2002) found vertical features, business and usage services to be among the most overpriced telecommunications.

3.3.5 Summary

The above findings were on research studies conducted in European and American telecommunication markets and therefore may not be generally applied to South African telecommunications market. Moreover some of the research findings were in already fully competitive markets in the fixed-line sector. However the findings do provide a solid basis to evaluate the management of the pricing policies by Telkom in the South African fixed-line telecommunications market despite the fact that the fixed-line part of the sector is still monopolistic. Mobile operators have provided a form of competition to Telkom and choice for the communications customers.
3.4 The factors influencing the ICT sector in South Africa

- **Independent Communications Authority of South Africa**
  The Independent Communications Authority of South Africa (ICASA) is the regulatory body of the telecommunications and broadcasting in the ICT sector. ICASA’s mission is to create a competitive environment for delivering high quality communication services at affordable prices in order to assist in the overall economic growth and social development of the country. Telkom’s price changes are submitted to ICASA for approval before implementation.

- **The ministerial or governmental influence**
  According to Securities Exchange Commission filing (20-F form, March 2007), the South African government owns 38.9% of the issued share capital of Telkom and as such still do have some level of control over the management of Telkom. Government’s concern with regards to the costs of doing business more especially telecommunications costs, was echoed by the President in his state of the nation address on the 9th of February 2007. and can also be evidenced in the announcements and the bills published.

  The minister of communications, Dr Ivy Matsepe-Casaburi, announced on the 2nd of September 2004 that “……because of technological developments there is no longer any difference in the
transmission of voice, video and data therefore it is no longer necessary to prohibit the provision of voice by VANS. This provision will allow growth of the VANS sector and promote SMMEs. I have now provided that as of 1 February 2005 value added network services may carry voice using any protocol. ......Currently, value added network services can only be provided through Telkom therefore we need to provide choice. I have now provided that as of 1 February 2005 value added network services may also be provided by means of telecommunications facilities other than those provided by Telkom and the Second National Operator or any of them........as of now, VANS are restricted from trading their telecommunications facilities in any way. I have now provided that 1 February 2005 shall be the date from when a person who provides a value added network service shall be entitled to cede or assign the right to use, or to sublet or part with control or otherwise dispose of the telecommunications facilities used for the provision of the value added network service”

The government published a notice of its intention to establish Infraco Broadband, an entity whose purpose is to provide affordable broadband access (Government Gazette no. 29879, May 2007)
• **Electronic Communications Act**

The preamble of the Electronic Communications Act No. 36 of 2005 reads “To promote convergence in the broadcasting, broadcasting signal distribution and telecommunications sectors and to provide the legal framework for convergence of these sectors; to make new provision for the regulation of electronic communications services, electronic communications network services and broadcasting services; to provide for the granting of new licences and new social obligations; to provide for the control of the radio frequency spectrum; to provide for the continued existence of the Universal Service Agency and the Universal Service Fund; and to provide for matters incidental thereto”.

The dynamic nature of the ICT industry means that organisations compete not only on the products and services but also on technologies to provide those services.

• **Introduction of competition and its cost implications**

Telkom is not only faced with competition from the second network operator in the form of Neotel but it also has to compete with the Value Added Network Service providers (commonly referred to as VANS). ICASA is currently converting operating licences based on
the new Electronic Communications Act which would give the VANS licence to provide Voice over Internet Protocol (VoIP).

The introduction of mobile telephony has resulted to competition in voice services resulting to the current 84% mobile penetration levels for the South African population (20-F form, March 2007). This migration of customers is commonly referred to as fixed to mobile substitution. Therefore even though fixed line telecommunications companies have had no legal competition in terms of providing PSTS based voice services, competition has existed in the form of mobile voice services.

In a competitive environment, a decline in IT cost over time provides a cost advantage to the later entrant making the incumbent’s investment decision challenging (Demirhan, Jacob and Raghunathan, 2006). The new entrant enters the market with a cost advantage and therefore lower prices. Demirhan, et al (2006) further argue that in a price sensitive market the competitor’s price affects demand significantly more than the competitor’s quality. The quality of PSTS network is undoubtedly better than that of Internet Protocol however the growth of VoIP technology over the past few years has improved the quality. The aggressive marketing and claimed growth
of VoIP call traffic over the last few months is an indicator of the price sensitivity of the market.

- **Performance indicators of the industry**

  Regulator’s success is generally measured by the amount of market share loss that has been experienced by the incumbent operator. One of the strategic objectives of ICASA is to promote pro-competition market and also to establish regulatory policies that promote competition and innovation. Therefore indications of anti-competitive behaviour by the incumbent are bound to attract the attention of the regulatory body because of its direct impact on the regulator’s performance.

  The importance of key performance indicators and measures cannot be underestimated if one has to analyse the pricing policies of organisations. The most common profitability measure in the telecommunications sector is the earnings before interest and tax (EBIT) margin. Organisations are therefore most likely to develop pricing policies that are in line with the expectations of the investment community in terms of the margin. The flaw with this measure is that the margin may increase whilst the absolute value is declining and vice versa. The expected target returns may therefore lead to overpricing.
Chapter 4: Research methodology

4.1 Introduction

Fixed line telecommunications has gone through a number of changes in last few years from being a nationalised telephone company to a privatised company with exclusivity rights to listing at the Johannesburg Stock Exchange and preparing for competition. Throughout this period, its pricing policies have evolved probably to suit the market conditions of the time. Voices of dissatisfaction with Telkom's price have become louder in recent times from ordinary users of telecommunications services to government officials who see it as a hindrance to growth and economic development.

This chapter states the research problem, explains the research approaches, sampling, method of data collection as well as method of data analysis.

4.2 Problem statement

Biggs and Kelly (2006) found that the pricing strategies have major implications for future development in the telecommunications sector as they are dismantling the constructs on which the telecommunications services have historically been priced. Kollman (2000) argues that deregulation and telecommunications market liberalisation led to tough international competition which is very sensitive to decisions in pricing policy.
The research therefore seeks to analyse Telkom’s pricing policies and how these have changed over the period to meet customers’ expectations as well as company future plans in anticipation of market changes within focus on the following objectives:

- to understand the relevance and nature of the pricing policies that have been adopted by the incumbent fixed-line operator Telkom.
- to critically evaluate the management of the pricing policies in the periods of changes in the market landscape more especially within the context of regulation and the imminent competition from VANS and Neotel.
- to research the impact of Telkom’s pricing policy decisions on its business.
- to research literature and theory relating to the management of pricing policies and to identify possible gaps as well as provide recommendations.

4.3 Research approach

Qualitative research and quantitative research are two approaches that can be adopted for a research project. Leedy and Ormrod (2005) define quantitative approach as a research used to answer questions about relationships among measured variables with the purpose of explaining, predicting and controlling the phenomena. Qualitative research is used to
answer questions about the complex nature of phenomena often with the purpose of describing and understanding the phenomena from the participants’ point of view.

This research is a combination of both qualitative and quantitative approaches. The qualitative aspect of this research seeks to understand the phenomena of pricing policies in the fixed-line telecommunications sector and how it has been managed. It is undertaken as a case analysis of Telkom SA as the sole fixed-line service provider in the market currently. From a quantitative perspective, managers in different levels within Telkom are interviewed both in structured and unstructured formats in order to understand the influences on pricing policies from the lowest levels.

Even though the processes of qualitative and quantitative research are similar, the research methods involved are different. The next paragraphs explain the methods that will be followed.

4.4 Sampling procedures and methods
A sample is a selection of objects on which the research is to be conducted. The results from the sample are then extrapolated to make generalisations about the population. Population refers to the total objects on which the inferences of the results could be made. Analysing the entire population is called census and could be very expensive.
Diamantopoulos and Schlegelmilch (2005) identify two categories of sampling procedures as probability sampling and non-probability sampling. Probability sampling is whereby each element of the population has an equal chance of being included in the sample whilst non-probability sampling leaves the sample selection to the discretion of the researcher.

The non-probability sampling procedure could be in the form of any of the following sampling methods:
- Convenience sampling method is when sample members are selected on the basis of their being readily available at the convenience of the researcher.
- Judgemental sampling method is when sample members are selected based on the judgement of the researcher on what constitutes a representative sample
- Purposive sample refers to a method of selecting the sample with a specific purpose or objective in mind
- Quota sampling method is when there is a preset criterion for the said to represent the population and therefore the sample members’ selection is based on such qualifying criteria.

Probability sampling procedure involves the following methods:
- Simple random sampling method refers to a process of selecting sample members randomly from a population
- Systematic sampling method is when sample members are selected at regular intervals after a random start.
- In stratified sampling the population is divided into different segments and then sample members are selected randomly from these different segments.

Qualitative research is intentionally non-random in the selection of data sources and therefore sampling is purposeful (Leedy and Ormrod, 2005). For the quantitative part of the research the sample members for the interview were randomly selected from the population of the managers who have an influence and input into the pricing on products and services. A stratified sampling method was employed by dividing the population into marketing and finance segments from which the sample members were then chosen.

4.5 Method of data collection
Data was gained through conversations and interviews and also official records and documents mostly from publicly available information. In order to increase probability of the likelihood of the observations, the research has adopted as strategy of triangulation. Triangulation is the collection of multiple data sources such that they converge to support the observation.
The information that will be used for the purposes of this study will be a historical account detailing changes in the market landscape, the summary of historical financial statements of the organisation with focus mainly on the contribution of different revenue streams, study of different tariff filing information as submitted to ICASA and unstructured interviews with senior management involved in pricing decisions as well as a structured interview with the marketing and finance managers who have an input into the pricing of services and therefore have an influence in the management of pricing policies.

- **Conversations and interviews**

Unstructured conversations and interviews were held with three senior management members who have mostly been involved either with the management of pricing strategies. These conversations and interviews have been semi-structured to allow for flexible direction of the responses as well as follow-up questions. The kind of questions that were asked included the following:

1. What do you think of Telkom’s current pricing policy?
2. What do you think would be the pricing strategy of Neotel?
3. What is Telkom’s view on price war with competitors?
4. How much influence has Telkom’s pricing policies had on the financial status of the company?
5. What is the readiness status of Telkom with regards to competition?
6. What factors are considered in Telkom in developing pricing policies?
7. Which service organisation within Telkom has the greatest influence on the determination of the prices of services?
8. How do you think the pricing policies serve to support the organisational objectives within the company?
9. What has been the influence of exclusivity granted to Telkom on the customer service, infrastructure investment and pricing of the services?

The structured interviews with the middle and lower level management required the interviewees to select from a choice of answers that were already provided with the questions. The interviews were to gauge the influence of inputs of marketing and finance into the pricing policies and also to determine the cohesiveness of the top-level pricing strategy with the implementation of the pricing policies.

- Records and documentation

Due to the lack of access to the prior period’s pricing policy documents and the fact that the organisation does not allow the use of official documentation for research purposes, the pricing policies of the organisation are assumed to be implicit in the various positions that the company has taken in the way it adjusted its tariffs, packages and calling plans it has provided as well as the products that the organisation has
decided to adjust. Public commentary both from Telkom and external persons was also used in the research.

Financial statements and results information were sourced from Telkom’s Investor relations website. Also some of the media statements from the website were used in the research analysis.

4.6 Method of data analysis
The research will therefore be the analysis of historical pricing policy documentation, the tariff filing done with ICASA, tracking specific initiatives, interviews with management and also the historical financial statements. The research will be looking into the pricing policy documents to determine the formal or informal nature of decisions in the organisation.

The pricing policy documents will be studied to provide the insight into intended objectives of the decisions as well as to establish the trend and patterns in the objectives. The correlation is also drawn with the financial statements’ revenue contributions and any changes that could be attributable to the pricing policies. Furthermore the expected changes or recent market changes are correlated to the pricing policies and the results as seen in the financial statements.
Tariff filing with ICASA will determine the alignment between the organisations pricing policy and public information. The deviations between ICASA filing and documented pricing policies and strategies will be analysed with the aim of assessing the impact of price regulation on the organisations policy. Furthermore this comparison should provide information on the discounting impact on the pricing policies.

Bundled services whose success depends on the other services will be tracked over a period seeking to find a trend and any clues on cross-subsidisation among the organisation’s services. The manner in which these services are filed with ICASA as part of basket services should be of assistance as it will determine how the organisation utilises the advantages it has to maximise returns. The take up of the bundles could also provide information on the success of value pricing which most of the telecommunication organisations are attempting to embrace and adopt.

Lastly the interviews with management are to provide general management view on the organisation’s pricing policies and also to provide the necessary information on who is responsible for the prices in the organisation and how prices are determined. Greater involvement of finance in the determination of prices will for an example indicate a cost-based whilst marketing will for an example be more inclined towards value-based pricing strategy.
4.6 Limitations

Telkom’s policy does not allow access or use of company documentation for research purposes if that documentation is not already in the public domain, therefore documentation such as the strategy documents detailing the organisations objectives could not be obtained. These documents would have been useful in aligning the pricing policy to the organisation objectives. The following assumptions were also made in the data and analysis:

- Where prices for business and residential are different, residential tariffs were used.
- Minimum call charges for usage traffic were excluded from the data
- Telkom collapsed long distance bands for long distance from 2 to 1. The study only used 50km – 100km in instances where 50km-100km and >100km bands still existed in the data.
Chapter 5: Research results

5.1 Introduction

This chapter contains the research results from the different sources of information that were used and these results are interpreted in this chapter. The results summarised from interviews and information that was gathered from the conversations and interviews process are used in the interpretation of information.

5.2 Sources of information used

The following sources of information were used in the research:

- Published tariff books of Telkom for ICASA tariff filing
- Prospectus used for the Initial Public Offering (IPO)
- Published financial statements
- Conversations and interview with three senior management members
- Structured interviews with marketing and finance managers

5.3 Results presentation

The results are presented per line item that was studied but it is important to note that it is the combination of all these aspects that allows for a holistic assessment of the pricing policies within the organisation.
5.3.1 Access deficit

This analysis was to explore the relationship between the changes in the number of subscribers and the subscription fees.

**Figure 5.3.1**

![Access Line Rental Per Month](chart1)

Source: Telkom tariff books

**Figure 5.3.2**

![Voice lines and Penetration rates](chart2)

Source: 20-F form
Figure 5.3.1 shows that Telkom’s access line rental charge has doubled over the last eight years whilst figure 5.3.2 shows a general decrease in the number of lines over the same period. More concerning is the declining penetration rate of fixed line services from 12.8% in 2000 to the current 9.8% of 2007. The real increase after considering the impact of Consumer Price Index (CPI) over the period of analysis is 40%. To put these numbers into perspective, if Telkom was not allowed by the price-cap regulation to selectively alter prices, the increase over the last four years would not have exceeded 2.5% per annum.

Telecommunications sector is capital intensive and most of its costs are fixed. As the number of fixed access lines decreases, the cost per subscriber increases. Margins are generally lower in fixed-line access subscription and therefore the reduction in the number of subscribers creates an access deficit. Access deficit occurs when the costs of providing a fixed-line access service are greater than the subscription fee for the fixed-line access. Therefore the increase in the subscription fees is an attempt to recover the costs of providing access which are increasing per subscriber as the number of fixed access lines are decreasing.

5.3.2 Tariff rebalancing

Figure 5.3.3, Figure 5.3.4 and Figure 5.3.5 represent the view on the changes made to the main fixed-line traffic drivers in the organisation. Local and long distance traffic account for about 80% of the company’s total outgoing traffic.
Therefore changes to the rates of local and long distance traffic would explain with a certain level of significance the pricing strategy of the organisation.

**Figure 5.3.3**

<table>
<thead>
<tr>
<th>Year</th>
<th>Rate per minute (cents)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>0.10</td>
</tr>
<tr>
<td>2001</td>
<td>0.20</td>
</tr>
<tr>
<td>2002</td>
<td>0.30</td>
</tr>
<tr>
<td>2003</td>
<td>0.40</td>
</tr>
<tr>
<td>2004</td>
<td>0.30</td>
</tr>
<tr>
<td>2005</td>
<td>0.30</td>
</tr>
<tr>
<td>2006</td>
<td>0.30</td>
</tr>
<tr>
<td>2007</td>
<td>0.30</td>
</tr>
</tbody>
</table>

Source: Telkom tariff books

**Figure 5.3.4**

<table>
<thead>
<tr>
<th>Year</th>
<th>Rate per minute (cents)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>0.20</td>
</tr>
<tr>
<td>2001</td>
<td>0.40</td>
</tr>
<tr>
<td>2002</td>
<td>0.60</td>
</tr>
<tr>
<td>2003</td>
<td>0.80</td>
</tr>
<tr>
<td>2004</td>
<td>1.00</td>
</tr>
<tr>
<td>2005</td>
<td>0.80</td>
</tr>
<tr>
<td>2006</td>
<td>0.60</td>
</tr>
<tr>
<td>2007</td>
<td>0.40</td>
</tr>
</tbody>
</table>

Source: Telkom tariff books
Telkom began with a tariff rebalancing process early in 2000 with an intention of bringing long distance tariffs in line with local tariffs in accordance with international norms. The lower local tariffs were being cross-subsidised by long distance call charges. National domestic traffic tariffs increased significantly over the period between 2001 and 2003. Local traffic tariffs stabilised after 2003 but local off-peak tariffs have been gradually increased.

From 2003, long distance rates were however decreased as part of tariff rebalancing which led to changes in the ratio of tariffs for long distance calls to all destinations over 50 km compared to tariffs for local calls declining from a ratio of 3.3:1 to local calls as of 2000 to 1.7:1 as of 2007. Local traffic accounts for about 65% of Telkom’s total outgoing traffic. Since local peak rates have stayed constant for the last few years whilst off-peak rates have shown a small gradual increase, it can generally be concluded that tariffs for 65% of Telkom’s traffic have increased over the period.

**5.3.3 Broadband (ADSL) prices**

ADSL was launched in 2003 financial year as a niche product targeted at the high end of the residential market. The graphs below indicate the history of the service including number of subscribers as well as tariff changes for the period.
Figure 5.3.5 shows the history of ADSL prices since launch and figure 5.3.6 graph indicates the take up of ADSL since launch. The service was launched with only 512kb/s offering but the company later to introduce a further three additional offerings in the form of 192kb/s, 384kb/s and 1024kb/s (the 192kb/s
service was later discontinued and upgraded to the 384kb/s). These later offerings were the company's response to the demand of the service from the middle to the lower end of the market. The tariffs have been reduced significantly with the 512kb/s price currently half the launch price. The market response to these reductions indicates higher levels of price sensitivity in telecommunications connectivity services despite the market monopoly in fixed-line telecommunications.

Telkom employed market-skimming pricing strategy in introducing ADSL as a niche product initially intended for the upper end of the residential market and later gradually reducing the prices to allow general market penetration pricing strategy.

5.3.4 Calling plans/packages
Telkom has in the recent past introduced products and services to improve the value proposition to its customers by launching new bundled packages and enhancing existing packages. This has resulted to calling plans such as TelkomCloser and SupremeCall offering customers discounted packages either in the form of pure per second benefits or free minutes. These are value based packages aimed at retaining its customers and market positions. Since these packages and calling plans are new, their success in achieving the intended results is yet to be tested. The packages and calling plans are however a good indicator of Telkom's move towards a value based pricing approach.
5.3.5 Financial results over period

The intention of the financial results analysis is to analyse any possible shifts between usage traffic and subscriptions in terms of the mix. This would indicate any move towards value-based pricing and the impact on the EBITDA margins.

**Figure 5.3.7**

![EBIT Analysis](source: 20-F form)

**Figure 5.3.8**

![Revenue per category](source: 20-F form)
Figure 5.3.9 above indicates that usage based revenue reached its peak in 2004 and thereafter began a decline. This is in line with the aggressive tariff increases as indicated above in tariff rebalancing discussion. However the increase in subscriptions seems to be in line with the sustained tariff increase approach that the organisation has adopted with regards to fixed-line access.

5.3.6 Positioning for competition

The company has adopted a retention strategy which offers term contracts to its business customers in exchange for volume discounts. The organisation is in this instance using a differential price adjustment strategy to protect its market ahead of competition. The tariff rebalancing process has also been in preparation for competition not only to align with international norms but also to close any gaps that could create arbitrage opportunities for competition.

Furthermore the provision of value-based TelkomCloser calling plan is a strategy of ensuring that residential customers also do benefit from their association with Telkom thus improving customer satisfaction and probability of retaining the customers. This strategy is still new and could be a subject for future research.

5.3.7 Costs

Even though the study did not necessarily look at the costs of providing services, based on the findings of other researchers telecommunication sector
still uses cost based approach in its pricing. This was also prevalent from the discussions with the members of the senior management who indicated the involvement of finance for costing of network elements in the determination of pricing of newer products. This is not necessarily a bad thing because the floor price below which the products may not be sold at a loss and also this info is required to assess the profitability of the individual services. Even though involved in the costing, finance seemed to play an advisory role rather than determining prices the responsibility of which lies solely with marketing.

It is difficult to prove cross-subsidisation in telecommunications because the costs of the networks on which the products are provided are mostly fixed and shared. Cross-subsidisation can only be tested using the costs for each service which can prove not to be easily possible in this sector. The price-cap regulation also in some way promotes cross-subsidisation within the services in the basket. Arguments exist that the margins in the usage tariffs are subsidising the higher costs of providing access.

5.3.8 Regulator influence

The price-cap regulation as discussed under the price-cap heading in chapter 2 includes a productivity factor which must be subtracted from the inflation measure in order to get the overall allowance tariff adjustments for services that fall within the basket. ICASA increased the productivity factor from 1.5% to
3.5% effective from 2005. This in effect means that the overall rate by which tariffs could be increased was decreased.

5.3.9 Interview findings

The unstructured interview with senior management of Telkom was mostly in open ended questions in order to identify similar themes across all three interviews. The following observations were made with regards to management of pricing policies:

- Management sees the price-cap regulation as a barrier to the flexibility of the pricing policies and that some of the pricing polices may not the implemented under the current regulatory dispensation.
- The view that Telkom has done enough to position itself for competition was prevalent in the discussions. As a result it was not foreseen that Telkom would enter into price war with competitors.
- There was no clarity with regards to the organisational objectives. This is concerning since the pricing policies exist to support the organisational objectives.

The structured interview yielded the following results:

- 70% of the interviewed managers think that Telkom’s pricing policies are well managed within the regulations. Two thirds of the 30% that disagreed are from finance environment.
- On the question of readiness for competition, 40% of managers think that Telkom is ready whilst another 40% think that Telkom is not yet ready. The other 20% said they do not know.

- The majority of the managers think that Neotel will try to match Telkom’s current prices, that was the view of 80% of observations. Of the remaining 20%, 10% said that Neotel will focus on quality and not price whilst the other 10% said that Neotel will price below Telkom prices.

- On the question of how the prices should be determined, value-based approach was the most preferred with the cost of providing the services voted second. Price-cap regulation was the least favoured. Price-cap regulation was ranked the number one when it came to the influences on Telkom pricing policies followed by public expectations.

The results of this interview indicate that there is not a single view within Telkom on how competition is to be handled with regards to price. Further more the practice of cost based pricing is still very much entrenched in the organisation even though the views are changing towards value-based pricing approach within the organisation.
5.4 Findings with regards to research objectives

5.4.1 Relevance and nature of pricing policies

The non-existence of the pricing policy documentation in the organisation indicates an informal nature of the pricing policy decisions. It further indicates a possible disconnect between the organisational objectives and the business strategies. The significant tariff increases of 2001 to 2003 of tariffs for traffic and fixed connection charges as shown in figure 5.3.1, figure 5.3.2, figure 5.3.3 and figure 5.3.4 show the disconnect between pricing policies on Telkom and literature and latest international trends of international telecommunications. Previous researchers have argued that the fixed costs should be dropped in favour of usage based charges in order to stimulate further usage which has higher margins. Figure 5.3.1 further indicates a monopoly tendency of charging the highest prices for the services in captured markets.

5.4.2 Management of pricing policies

The organisation adopts a different pricing strategy for each of its different products. This is attested to by the market-skimming pricing strategy it adopted with ADSL and the value-based pricing strategy for its TelkomCloser packages. The pricing policy of the organisation is guided mostly by the tariff rebalancing process. Other than the tariff rebalancing process, there is a lack of an over-arching guide to pricing policies that connects it to the organisational objectives.
5.4.3 Impact of the pricing policies

The pricing policies and strategies adopted by the company have not been in the public interest. This can also be related to the current case brought by the Mweb against Telkom on margin squeeze. The initial higher tariff increases by the organisation have resulted to good financial performance as evidenced by higher EBITDA margins of the years thereafter. The current pricing policies have also resulted to arbitrage opportunities which could now be exploited by the VANS providing VoIP and also even by Neotel. Intensified competition might lead to reactionary strategies by the organisation when given the market power it currently has, it should be dictating to an extent the direction of the telecommunications sector.
Chapter 6: Discussion, conclusions and recommendations

6.1 Introduction
This chapter summarises the research findings, draws conclusions and makes recommendations on the pricing policy management of Telkom more especially in the face of increased competition and technology convergence.

6.2 Discussion of results
Fixed-line telecommunications residential market is a highly price sensitive market that requires caution and guided direction in the way that the pricing policies are implemented whilst business is more quality sensitive. The sensitivity is despite the monopolistic nature of the market because of the availability of substitute products. The adoption of a market skimming-policy for ADSL might not be a relevant strategy considering the reaction of the market in terms of volumes after the tariff reductions. The strategy left a lot of space for competition in terms of mobile broadband internet access.

The market is still very much driven by cost-based pricing which could be seen from the tariff rebalancing process which is more about costs. The extent to which this has affected the organisation in terms of profitability and value is yet to be determined. However the organisation also has to satisfy the regulator that is not excessively charging the market and thus abusing its monopoly.
The pricing policies have been managed with very short term objectives of ensuring maximum profitability possible under the regulation even though the regulation itself has stifled flexibility in terms of the pricing policies.

In the absence of other strategies, the impact of the pricing policies adopted by Telkom could be detrimental to competitive success in terms of the arbitrage opportunities that have been created. Furthermore the stakeholder management in the process needs to be strengthened to ensure wider buy-in on the pricing policies and strategy.

6.3 Conclusion

The purpose of the study was to critically evaluate the management implications of the pricing policies in Telkom SA with objective of analysing the relevance, impact of management of these pricing policies within the organisation. This was done by first studying the theory and factors that influence pricing policies in organisations as well as different strategies that the organisations may adopt under different conditions.

There are gaps that exist between the theory, research literature and how Telkom SA manages these policies. The major source of the problems in Telkom SA pricing polices is the absence of such documentation indicating the informal nature of the policy decision. Furthermore it provides no
reference for those who would want to understand the pricing direction of the organisation even though for the purposes of this research, this problem was overcome by the utilisation of the publicly available information to form a view on the pricing policies. The recommendations below could assist in remedying some of the problems.

6.4 Recommendations

- Telkom needs to link the pricing policies to the overall organisational objectives and document these policies. The findings of interviews in 5.3.9 should be a concern for an organisation that is about to face competition. It is suggested that the chief of sales and marketing be tasked with the responsibility of ensuring that the pricing policies are developed and documented within the next three months to ensure that there is a single point of reference for the management of the pricing policies in order to ensure coherence and alignment with the organisational objectives.

- The pricing policies need to be discussed with the board of directors in order to avoid the public disapproval of its pricing policies by some of the shareholders.

- Telkom will have to sacrifice short-term gains for sustained future growth. Telkom may for an example start providing a voice line for free to its customers but stimulate usage based revenue which has higher margins and earn customer loyalty before competition.
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### Table 8.1: Trend of local tariffs from 2000 to 2007

<table>
<thead>
<tr>
<th>Local rate per minute</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Peak</td>
<td>0.16</td>
<td>0.18</td>
<td>0.29</td>
<td>0.33</td>
<td>0.33</td>
<td>0.33</td>
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</tr>
<tr>
<td>Off-peak</td>
<td>0.05</td>
<td>0.07</td>
<td>0.11</td>
<td>0.12</td>
<td>0.13</td>
<td>0.14</td>
<td>0.14</td>
<td>0.15</td>
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### Table 8.2: Trend of long distance tariffs from 2000 to 2007

<table>
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<tr>
<th>Long distance rate minute</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Peak</td>
<td>0.53</td>
<td>0.53</td>
<td>0.68</td>
<td>0.87</td>
<td>0.87</td>
<td>0.70</td>
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</tr>
<tr>
<td>Off-peak</td>
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<td>0.26</td>
<td>0.39</td>
<td>0.43</td>
<td>0.43</td>
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<td>0.32</td>
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### Table 8.3: Trend of ADSL tariffs from 2003 to 2007

<table>
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<tr>
<th>Broadband ADSL per month</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
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<th>2007</th>
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</thead>
<tbody>
<tr>
<td>384kb/s</td>
<td>596.49</td>
<td>314.91</td>
<td>214.91</td>
<td>133.33</td>
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<tr>
<td>512kb/s</td>
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<td>418.42</td>
<td>317.54</td>
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<td>1024kb/s</td>
<td>452.63</td>
<td>452.63</td>
<td>452.63</td>
<td>452.63</td>
<td></td>
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### Table 8.4: Trend of EBIT margin from 2000 to 2007

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<thead>
<tr>
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<tbody>
<tr>
<td>Revenue</td>
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<td>23,934</td>
<td>25,491</td>
<td>27,021</td>
<td>28,360</td>
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<td>18,313</td>
<td>17,760</td>
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<td>Subscription</td>
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<td>4,197</td>
<td>4,410</td>
<td>4,595</td>
<td>5,024</td>
<td>5,316</td>
<td>5,803</td>
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</tr>
<tr>
<td>Data</td>
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<td>3,913</td>
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<td>5,023</td>
<td>5,810</td>
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<tr>
<td>EBIT amount</td>
<td>8,056</td>
<td>8,052</td>
<td>6,788</td>
<td>9,826</td>
<td>12,609</td>
<td>12,711</td>
<td>14,646</td>
<td>12,663</td>
</tr>
<tr>
<td>EBIT margin</td>
<td>34%</td>
<td>30%</td>
<td>24%</td>
<td>33%</td>
<td>41%</td>
<td>40%</td>
<td>45%</td>
<td>38%</td>
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### Table 8.5: CPI at the end of March from 2000 to 2007

<table>
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<tr>
<th></th>
<th>2001</th>
<th>2002</th>
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<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>CPI</td>
<td>7.4%</td>
<td>6.2%</td>
<td>10.2%</td>
<td>0.4%</td>
<td>3.0%</td>
<td>3.4%</td>
<td>6.1%</td>
</tr>
</tbody>
</table>

### Table 8.6: Trend of line rental tariffs at nominal and real rate increases from 2000 to 2007

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Based on nominal increases</td>
<td>50.23</td>
<td>55.00</td>
<td>59.40</td>
<td>66.84</td>
<td>71.84</td>
<td>80.95</td>
<td>87.65</td>
<td>98.16</td>
</tr>
<tr>
<td>Based on real increases</td>
<td>50.23</td>
<td>51.28</td>
<td>52.21</td>
<td>53.42</td>
<td>57.20</td>
<td>62.74</td>
<td>65.80</td>
<td>69.68</td>
</tr>
</tbody>
</table>

### Table 8.7: Trend of voice lines and penetration percentages from 2000 to 2007

<table>
<thead>
<tr>
<th>Voice lines</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of access lines</td>
<td>5.5</td>
<td>5.0</td>
<td>4.9</td>
<td>4.7</td>
<td>4.7</td>
<td>4.7</td>
<td>4.7</td>
<td>4.8</td>
</tr>
<tr>
<td>Penetration percentage of voice lines</td>
<td>12.8%</td>
<td>11.4%</td>
<td>11.1%</td>
<td>10.4%</td>
<td>10.1%</td>
<td>10.1%</td>
<td>10.0%</td>
<td>9.8%</td>
</tr>
</tbody>
</table>