COMPETITION AUTHORITY OF KENYA

Creating efficient markets for consumers

COMPETITION AUTHORITY OF KENYA SUBMISSION: REGULATORY BARRIERS TO COMPETITION IN PROFESSIONAL SERVICES REFORM EXPERIENCE

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A. INTRODUCTION

1. Regulation of professional services have both negative and positive effects depending on the elasticity, the supply-side constraints and the nature of the service. There are essentially three reasons why regulation of professional services could be necessary:
    i. **Information asymmetry** between consumers and providers, as a defining feature of professional services is that they require practitioners to display a high level of technical knowledge which consumers may not have;
    ii. **Externalities**, as these services might have an impact on third parties; and
    iii. Certain professional services are deemed to **produce 'public goods'** that are of value for society in general. However, such regulations may eliminate or limit competition between service providers and thus reduce the incentives for professionals to work cost-efficiently, to lower prices, to increase quality or to offer innovative services. Examples[1] across the world show the mixed effects the removal of price controls have had on consumers and competition.

2. The Competition Authority of Kenya's ('**the Authority**') Product Market regulatory (PMR) Report of November 2015, titled: `**Unlocking Growth potential in Kenya, Dismantling regulatory obstacles to Competition`,** among others, highlights that removal of restrictive product market regulations in the professional services would result in an increase of the GDP growth by at least 0.39 percent.

3. In addition, the Report indicates that the Kenya's Professional services are characterized by two categories of regulatory regimes, namely; entry and conduct regulations. The entry regulations include higher number of years of education, compulsory practice, compulsory exams, membership requirements and quota system for foreigners. The conduct regulations refer to existing regulations by the government, regulations on marketing and advertising and restrictions on one-stop shopping.

4. Specifically, the Report identifies rules that are most likely to restrict competition among Kenya Professional service. These include:
    a. **Fixed prices** - Reduce the benefits that competitive markets deliver onto consumers, severely limiting consumers' choice.
    b. **Recommended Prices** - has a negative effect on competition as it might facilitate coordination of prices between practitioners.

[1] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52004DC0083&from=EN

c. **Advertising restrictions** – Denies information to consumers to enable them make better-informed decisions.
d. **Entry restrictions and reserved rights** - Excessive licensing regulation likely reduce the number of suppliers of services.
e. **Regulations governing business structure and multi–disciplinary practices -** Business structure regulations may have a negative economic impact if they prevent providers from developing new services or cost-efficient business models. For example, the regulations might prevent lawyers and accountants from providing integrated legal and accountancy advice on tax issues or prevent the development of one-stop shops for professional services in the rural areas, where there is equally great need for the professional services.

5. Based on the Report, Kenya's PMR score (a measure of the intensity of regulations) for the accounting, legal and architecture professions was found to be higher than the average score for OECD countries and Latin America-Caribbean average. This scenario has a multiplier effect across the other sectors of the economy that rely on these professions, especially the finance sector which has a lot of contractual agreements. This negatively affects the competitiveness of the economy as a whole.

6. Professional services are central to the realization of the Kenya's Vision 2030, as they play a critical role in the Housing sector (Surveyors, Architects, and Accountants); Health Sector (Doctors, Pharmacists, and Accountants); Manufacturing including the Agriculture Sector. Therefore, a competitive professional services sector could impact the achievement of the Vision.

7. The following sections of this paper present the Authority's position on competition in the professional services, reforms in Kenya and way forward in implementing the PMR report.

B. COMPETITION IN PROFESSIONAL SERVICES SECTOR

8. Professional services are characterized by information asymmetry given that it is a peculiar type of good that rides on trust and goodwill, built over time based on recommendations from trusted sources and quality of repeat services offered by the professional to a consumer. Therefore, it is referred to as a trust good, implying that by its very nature reconciling the outcomes of a service with the monetary value attached to it before receiving the service may be a complex task depending on the consumer. Additionally, the quality of professional services is subject to skills, training, knowledge, and expertise of the professional and cannot be assessed prior to procuring the service.

9. In the assessment of the outcomes of professional services, business and public sector consumers are expert consumers in comparison to individual or household consumers. They generally demand services that are tailor-made to their needs and have resources at their disposal that enable them acquire the requisite information when seeking and choosing desired professional services. Thus, information asymmetry is lower for the 'expert clients' in comparison to individual consumers.

10. The asymmetry in information results in the following problems for the consumer:
    - **Adverse selection**- a situation where the sellers have more information about some aspect of a product quality that the consumer does not have;
    - **Moral Hazard** – a situation where a professional provides a consumer with additional services that the consumer did not need, thus making the consumer spend more than they should have; and,
    - **Agent-Principle problem** - a situation where the seller is able to make decisions on behalf of the consumer or that impact on the consumer.

11. The problem that faces, especially the non-expert consumers of professional services, is therefore, assessing **quality** and **price** of services. The intervention to solve this market failure in professional services assessment, is either self-regulation or government regulation by a number of countries.

12. Regulation in a number of instances have prescribed certain measures to be followed by professionals to ensure that there is a bare minimum quality observed by professionals and in some professions, there are regulations that control prices charged. These can either be fixed prices or recommended prices:
    i) **Fixed prices:** These can either be maximum prices or minimum prices**.** The proponents of this form of pricing argue that eliminating price as a variable when the consumer is making a decision to procure professional services, allows the professionals to compete on the quality of services they render. Additionally, it protects the professionals from undercutting which is a common occurrence worldwide. Maximum pries have also been observed to protect consumers from the moral hazard challenge brought about by information asymmetry that results in market failure. Further, it protects consumers from exorbitant prices by professionals in sectors where the market has high barriers to entry and lacks effective competition resulting from other non-price related professional restrictions. However, in some instances fixed prices are detrimental to consumers in that they may end up getting prices that are not competitive; and,

ii) **Recommended prices:** These are often non-binding in nature and are set above the market equilibrium price by professional association regulation. They often inform the consumer of the average fees to be paid, for certain service, therefore, reducing the cost of transaction and by transitivity, lowering the fee to be paid by the consumer. It also reduces the burden of negotiation from the individual consumer who may not have full information necessary to negotiate the best price, especially in markets with high search costs. Recommended prices have also proven useful in acting as a guide to practitioners who lack experience in determining fees for services. Opponents of recommended prices, argue that recommended prices may facilitate coordination between service providers and may mislead consumers on the reasonable price to be paid, mainly because it is generated by the professional services. Some recommend that third parties such as consumer organizations should be the ones to publish such recommended prices. The effectiveness of the use of consumer organizations is subject to how strong and knowledgeable they are in different fields.

C. REGULATION OF PROFESSIONAL SERVICES IN KENYA

13. Internationally, setting of professional fee/price has been declared anti-competitive as it goes against public interest. As a matter of fact, competitive professional services improve the investment climate with countries such as Poland improving their economic ranking globally due to deregulation of prices of professional services.

14. Article 227 of the Constitution of Kenya, 2010[2] ("**the Constitution**") provides that the procurement of goods and services by the Government should be done through a system which, among others, is competitive and cost effective. Cost effectiveness can only be realized in a situation where the rates are influenced by forces of supply and demand.

15. The Authority is mandated to enhance the welfare of the people of Kenya by promoting and protecting effective competition in markets and preventing unfair and misleading market conduct throughout Kenya. Therefore, in an effort to ensure minimal disruption of operation of free markets, the Authority has in the recent past made interventions on professional associations which are intended to guarantee consumers better services at reasonable costs.

[2] http://www.kenyalaw.org/lex/actview.xql?actid=Const2010

16. The Kenya National Qualifications Authority (KNQA)[3] states that there are over twenty seven (27) Professional bodies and Associations that operate in the country and regulate the training and conduct of their members. It is worth noting that some are established under the Kenyan Law while others are a network of member.

17. Kenya's Professional services are characterized by two categories of regulatory regimes, namely; entry and conduct regulations. The entry regulations include higher number of years of education, compulsory practice, compulsory exams, membership requirements and quota system for foreigners. The conduct regulations refer to existing regulations by the government, regulations on marketing and advertising and restrictions on one-stop shopping. Rules that are most likely to restrict competition among Kenya Professional service include; Fixed prices, Recommended Prices, Advertising restrictions, Entry restrictions and reserved rights and Regulations governing business structure and multi–disciplinary practices.

18. In the recent past, there has been a shift by professional associations to fix prices for members. Indeed, some have enshrined this provision in their individual Acts. The Authority has over the past four years received three applications by professional bodies requesting to be granted exemption to set minimum prices, all of which were declined because the applicants did not demonstrate that the minimum pricing would result in a specific public benefit that would outweigh the lessening of competition. Introduction of fee guidelines would decrease competition, increase costs, reduce innovation and efficiencies, limit choices to consumers and raise the cost of professional services beyond the reach of come consumers. Further, the Authority was not provided with demonstrable negative impact or prejudice that the professions had suffered due to lack of a price setting mechanism nor evidence that price setting would increase the quality of services offered.

19. The Competition Act prohibits agreements by undertakings or association of undertakings that may distort of lessen competition. It also outlaws engaging in concerted practices which directly or indirectly fix prices or any other trading conditions in relation to provision of goods or services or maintenance of minimum prices. Contravention of these provisions attracts a penalty of up to 10% of the preceding year's gross annual turnover in Kenya. It may also result in criminal charges, liable to a fine of up to Ksh. 10 million and five years' imprisonment or both.

[3] https://www.knqa.go.ke/

20. Professional associations whose rules contain a restriction that has the effect of preventing, distorting or lessening competition in a market may apply for exemption by the Authority.

21. The process for application for exemption of professional rules is detailed in Section 29 of the Act. Prior to the 2014 amendment, Section 29 of the Act used to provide for a voluntary obligation on Professional Associations on whether or not to seek for exemption from the Authority. In line with international best practice, Parliament amended the Act in 2014 by providing for a mandatory obligation on Professional Associations to apply for exemption of their professional rules if they contain a restriction that has the effect of preventing, distorting or lessening competition in a market in Kenya. Section 29 of the Act places a mandatory obligation on professional associations to apply in writing for exemption of their professional rules which have the characteristic of *preventing, distorting or lessening competition in a market*. It is an offence under the Act to implement professional rules that impede competition, unless exempted by the Authority.

22. The Authority may exempt *all or part* of the professional rules for which a Professional Association has applied for exemption. Section 29 (2) of the Act sets out the criteria for granting of exemption as *restriction reasonably required to maintain professional standards or required for the ordinary function of the profession*. The exemption applications are pursuant to Section 29 of the Act which provides that *'a professional association whose rules contain a restriction that have the effect of preventing, distorting or lessening competition…shall apply… to the Authority for an exemption….'*

23. The process[4] through which an application for exemption by a Professional Association involves a written application to the Authority. The Authority then gazettes the application by publishing a Notice inviting interested parties to make representations on the exemption application. Further, the Authority is mandated to consult the Government agency or Ministry responsible for the administration of any law governing the profession with regard to the application for exemption by the Professional Association. The Authority then assesses the application taking into account the submissions, if any, by the interested party and the Government agency or Ministry, responsible for the professional association. Upon assessment, the Authority then communicates the decision by Notice in writing with respect to the exemption application together with the written reasons for its decision. Reasons are provided, only when there is an adverse determination which is in line with the Constitutional principle of Fair Administrative Action. The Notice is then published in the Gazette informing the public of the decision.

[4] https://cak.go.ke/sites/default/files/Competition-Act-No-1-%20of%202010-Amended-as-at-2019.pdf

24. In exempting, the Authority takes into account factors considered as outlined under section 26(3) of the Act, which includes whether these agreements: (i) contribute to or result in maintaining or promoting exports, (ii) improve or prevent decline in the production or distribution of goods or the provision of services, (iii) promote technical or economic progress, or stability in any industry, and/or (iv) obtain a benefit for the public which outweighs or would outweigh the lessening in competition.

25. The Regulatory Impact Assessment Guidelines[5] provides the conditions that may reduce competition in markets, including those that prevent firms from competing strongly or reducing their incentive to do so by setting prices. Setting prices limits the extent to which prices for goods and services are defined by market forces thus negatively affecting the consumer in terms of affordability and access. This further affects the suppliers negatively as there is no incentive to innovate, improve the quality of service and increase reach to the consumer.

26. Resultant benefits arising from deregulation of prices include improved quality of services as professionals now compete on other attributes besides price, such as customer service; lower prices for consumers as professionals were now competing on quality thus widening consumer choice and improved ease of doing business resulting from increased access to professional services.

D. CASE STUDIES FROM KENYA

Exemption Application by the Institute of Certified Public Accountants of Kenya

In Kenya, the accounting profession is regulated by the Accountants Act No. 15 of 2008. This Act defines the concepts of audit and audit firms and the requirements for one to become an auditor. The Act also established the Institute of Certified Public Accountants of Kenya (ICPAK).

ICPAK was established under the Accountants Act of 1978, and repealed under the Accountants Act No. 15 of 2008 and amended through the Finance Act, 2018. These amendments were aimed at strengthening the profession as well helping the government in the fight against graft. The Act now clearly distinguishes who an Accountant is by classifying them into the following categories; Trainee Accountants, Associate Accountants and Certified Public Accountant (CPA)[6]. The association has over 25,000 registered members.

[5] https://cak.go.ke/sites/default/files/Assessment of Regulatory Impact on Competition in Kenya.pdf

[6] https://www.icpak.com/wp-content/uploads/2018/10/AMENDMENDS-TO-THE-ACCOUNTANTS-ACT.pdf

The Institute is mandated to develop and regulate the Accountancy Profession in Kenya. It is also a member of the International Federation of Accountants (IFAC), the global umbrella body for the accountancy profession. The major statutory functions of the ICPAK[7] include designing and implementing policies regarding admission of membership, administering programs for members' professional development, ensuring adherence to professional ethics and standards, and taking disciplinary action against erring members.

Section 21 of the Competition Act (under Part III on Restrictive Trade Practices) prohibits agreements between undertakings, decisions by associations of undertakings and concerted practices unless these are exempted in accordance with section D of the Act; which provides that where an undertaking or association of undertakings wishes to enter into a prohibited agreement of practice, it has a mandatory obligation to apply for exemption from the Authority in accordance with Section 29 of the Act. The persons entitled to apply for an exemption are; any undertaking or association of undertaking and these include Trade Associations, Professional Associations and any corporate person. A Professional Association is defined under the Act in section 29 (7) as: *"…the controlling body established or registered* ***<u>under any law in respect of recognized professions</u>****, (our emphasis) but does not include trade associations and industry lobby institutions or bodies whether incorporated or not."*

ICPAK applied for exemption to be allowed to set minimum fees charged by its members on services offered, in 2016. In declining this request on proposed fees Guidelines, the Authority determined that introduction of fee guidelines would decrease competition, increase costs, reduce innovation and efficiencies, limit choices to consumers and raise the cost of Accountancy services beyond the reach of consumers.

Exemption Application by Institute of Certified Public Secretaries of Kenya (ICPSK)

ICPSK is a statutory body that is mandated to develop and regulate the Public Secretaries' Profession in Kenya. The institute is further mandated under the Certified Public Secretaries of Kenya Act, Cap. 534 of the Laws of Kenya to promote the practice of good governance and leadership through competence development of members and dissemination of knowledge and best practice to stakeholders. The institute has more than 3,000 members. The exemption application was submitted by ICPSK for a proposed minimum Governance Audit Fees Guidelines for its members for an indefinite period.

Fixing of price or rates by competitors is a *per se* prohibition under Section 21(3) and the presumption is that the object is to prevent, distort or lessen competition in the sector. As indicated above, ICPSK guide

[7] https://www.icpak.com/who-we-are/

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to fees aims at setting minimum fees to be charged by its members. Therefore, the proposed fees guidelines by ICPSK amounts to fixing pricing among competitors.

The anti-competitive clauses of the Guidelines were that ICPSK was providing minimum recommended fees to be charged by its members on various categories of professional services; monitoring prevailing conditions and issuing revised recommended fees as and when there is need; and providing a fair playing ground for all practitioners by providing the minimum fees charged for different services to prevent undercutting in the industry.

The Authority declined to grant exemption because the minimum fees proposed by ICPSK would not improve or prevent the decline in the provision of services, rather it would make the services costly and unavailable for customers. Further, minimum fees act as a disincentive to innovation, efficiencies, or technical progress aimed at reducing costs. Lastly, price regulation would have a resonating negative effect on other professional services that would contract the economy.

E. CONCLUSION

27. Low entry barriers, the need for the growing number of SMEs seeking business stability and compliance have opened up the professional services sector to new players. For instance, until 2002, the Accounting profession in Kenya was dominated by the Big 4 firms – PricewaterhouseCoopers, Ernest & Young, Deloitte and Touche and KPMG. Since then smaller (non-Big 4) firms have entered the market, to reach over seven hundred firms. This has increased consumer choice and affordability of accounting services.

28. Competition regulation in the professional sector has emerged as a key concern because of the detrimental effect it has on consumers' access to such services. These regulations control various aspects of the profession and the professionals that include, but not limited to, the entry into the profession, the conduct of members of these professions, the granting of exclusive rights to carry out certain activities and the structure of the organogram of the structure of the professional firms. The argument behind the regulation of professional services in Kenya is that it is meant to protect vulnerable consumers from market distortions that include charging of exorbitant prices. However, these regulations have become a great source of market distortions resulting in the upsurge of anti-competitive practices such as lack of innovation, poor quality services, among others.

29. The Authority, working jointly with the National Treasury and National Assembly studied the professional services sector in three countries, and opines that deregulation was done within the shortest time possible after the restrictions and their impact on the economy and the consumers had

been identified. Pursuant to this, the Authority has advocated for the following measures to be undertaken:

i. Repeal of all minimum prices contained in the laws, regulations and Codes of Conduct governing any profession in Kenya through amendment of these legislation and Codes of Conduct;
ii. Amend all legislations and advocate for the removal of price restrictions and any penalties arising from failure to observe the price restriction contained in the Professional Codes of Conduct;
iii. Removal of entry restrictions in professional associations in Kenya; prohibitive exams (whether oral or written), licensing or qualification restrictions;
iv. Repeal of all restrictions on advertisement and one-stop shopping (partnership between professionals who are in different professions) in the laws, regulations and Codes of Conduct governing any profession in Kenya through amendment of these legislation and Codes of Conduct;
v. Inserting of a provision in the laws and regulations setting maximum prices in professions which are identified as being in need of maximum prices so as to protect consumers; and
vi. Inserting of provision to give liberty for the negotiation of fees between a client and the professional on fees to be charged through an agreement. Further for a provision that the fee should be reasonable and the criteria for charging to be included in this provision.

30. Further, the Authority continuously engages stakeholders in the professional sector to educate them on the anti-competitive practices in the sector. They include the Law Society of Kenya, Engineers Board of Kenya, Institute of Certified Public Accountants of Kenya, Board of Registration of Architects, among others.

*** **END** ***