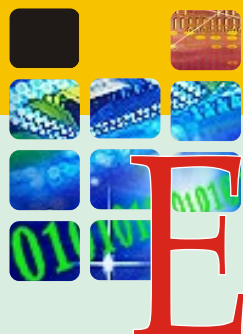


1

Economic Performance of Industry





Economic Overview of Pakistan

Pakistan's economy maintained strong growth rate in the fiscal year 2006-07; the economic growth rate was registered at 7%. Pakistan's economy has been rated as one of the fastest growing economy in the Asian region. East Asian economies like Malaysia, Indonesia, Thailand and Philippines grew at the rates between 5% and 5.5% mostly owing to robust growth in services, agriculture and manufacturing sector. Investment remained the driving force to boost the economy and the national economic indicators show that one could expect Pakistan to maintain 6-8% growth rate in the coming 5 years. Total investment at

23 percent of GDP has been reported the highest in the country's history. Private sector has played a pivotal role in investment whereby its share in total domestic investment has increased from 64.2% to 76% in the last 7 years, which indicates the confidence of investors in Pakistan's economy and the Government's economic policies. Similarly, per capita income is considered an important measure to gauge the standard of living of any country, which grew by about 11% in 2006-07 and reached US\$ 925 in 2006-07 from US\$ 586 in 2002-03. Factors such as GDP growth, high inflow of remittances and stable exchange rate are responsible for increased per capita income of Pakistan.

Table - 1
Pakistan Economic Facts 2007

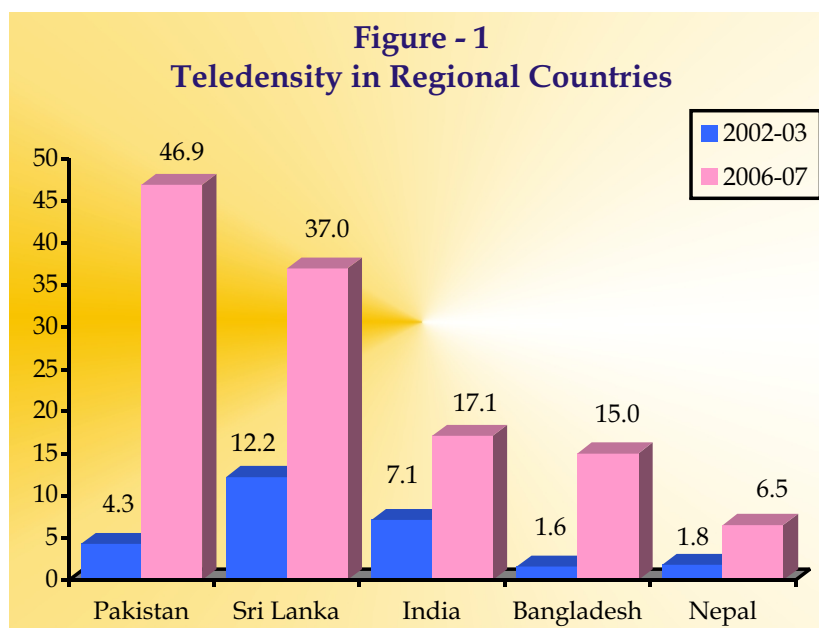
Indicator	2002-03	2003-04	2004-05	2005-06	2006-07
Real GDP Growth (%)	4.7	7.5	9.0	6.6	7.0
Foreign Exchange Reserves US\$ (Billion)	10.7	12.3	12.6	12.8	15.1
Per Capita Income US\$	586	669	733	833	925
Population (Million)	147	150	152	155	158

Source: Pakistan Economic Survey 2006-07, Ministry of Finance, Government of Pakistan

Services sector of Pakistan economy (telecom being part of it) continued to rise and registered about 1% growth over and above the national growth (8%)¹. Household Integrated Economic Survey of Pakistan (2005) has reported that poverty level in Pakistan has reduced considerably due to strong economic growth in the country. It also reported that social indicators like primary school enrollment and literacy rates have increased significantly². However, some macro economic fundamentals of the economy could not show the desired improvement. For example inflation was registered at 7.9% in 2006-07 despite tight monetary policy, and the current account deficit rose further due to rising trade gap and weak exports³.

Telecom Sector Overview

Analysts agree that in today's world telecommunications have become an enabling industry for business and commerce in particular and economy in general. A country's communications capabilities have become a reliable measure for their potential performance in the global economy. The more advanced the network, the greater its capacity and efficiency and hence, the greater its contribution to the overall economy. Maintenance of a stable and robust telecom infrastructure results in increased business and trade in the country thus resulting in economic growth in terms of increased investment, employment, government revenues GDP and Per Capita Income. Therefore, growth in telecom industry results in a multiplier effect on economic growth.



Infrastructure and subscriber growth patterns in Pakistan are unmatched all across the world. In-line with the extraordinary economic growth in Pakistan, the telecom sector of Pakistan has also been exhibiting thriving growth patterns especially in relation to South Asian economies including India, Bangladesh and Nepal. Today teledensity of Pakistan stands at 46.9% surpassing Sri Lanka's 37%. Similarly India currently has a teledensity of 15.4%, which is quite lower than that of Pakistan.

Fixed Teledensity has slightly declined from 3.4% in 2005-06 to 3.3% in 2006-07 which was just 2.1% in 1999. Major reason behind this decline is the churn of subscribers from fixed line to wireless based services like WLL and mobile services. WLL sector is performing well; its teledensity has improved from 0.7% in 2005-06 to 1.1% in 2006-07. Total subscribers of WLL in Pakistan are nearly

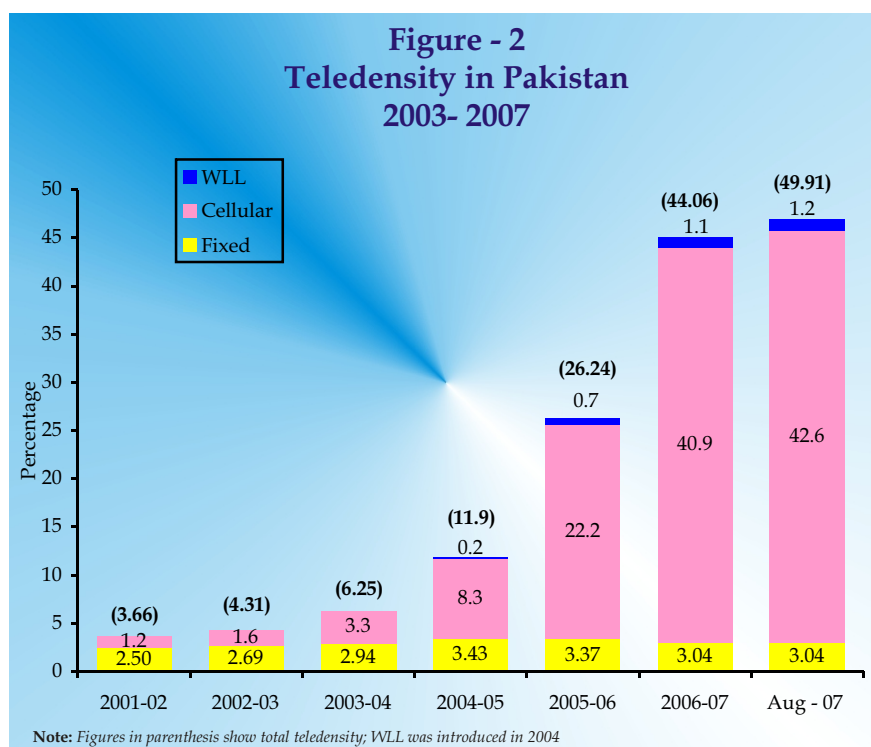
¹Pakistan Economic Survey (2006-07) Ministry of Finance, Government of Pakistan

²Household Integrated Economic Survey(2005), Federal Bureau of Statistics, Government of Pakistan

³Economic Update Pakistan (April 2007) Asian Development Bank

2 million which has contributed to the increase of teledensity. Total Teledensity of Pakistan has crossed 46%, thus placing Pakistan in the upper strata of Asian economies when teledensity is compared.

Prices of telecom services have reduced significantly due to competition among operators which is the major factor behind this impressive growth in teledensity. The operators have improved quality of service since PTA is continuously pursuing operators to meet international standards.



Imports of Telecom

Government of Pakistan is striving hard to decelerate total imports of Pakistan. Imports for 2006-07 were targeted to decline by 2.1%; however the total imports registered about 6.8% increase in 2006-07 (US\$ 30.5 billion) compared to last year's imports (US\$ 28.5 billion). The exponential growth in the telecom sector is burdening the overall imports of Pakistan where sector requires spending of about US\$ 1 billion just on the import of Cellular mobile handsets annually, which puts burden on our foreign reserves and increases the trade gap. During the last four years Cellular Mobile handsets worth US\$ 1.7 billion have been imported. In 2006-07 about 4.2% imports were for the telecom sector while this ratio was only 2.4% in 2003-04.

Table - 2
Telecom Imports

Description	US\$ Million			
	2003-04	2004-05	2005-06	2006-07
Cellular Mobile sets with Battery	144.1	371.1	569.2	670.2
Other Telecom Apparatus	234.8	406.3	628.3	677.5
Total	378.9	777.4	1,197.5	1,347.7
Telecom Share in Total Imports (%)	2.4	3.8	4.20	4.4

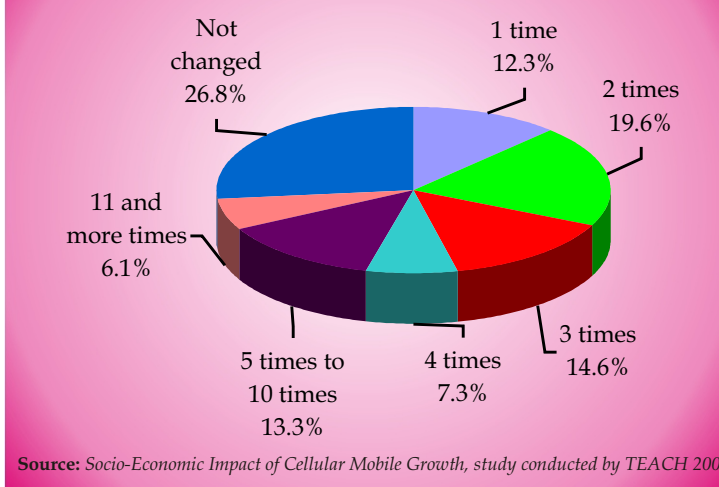
Government of Pakistan is contemplating offering incentives to lead manufacturers of cellular mobile handsets and telecom equipment to consider manufacturing of cellular mobile handsets and other equipments in Pakistan where cheap labor and other inputs are available. A lucrative market exists in Pakistan where about 2 to 3 million subscribers are being added on cellular mobile networks every month and still a large potential exists. According to an estimate cellular mobile companies have access to only 61% of the target market in Pakistan and they can still access the remaining 39%⁴. Pakistan's environment has been very conducive to Foreign Direct Investment since the last few years and the trend is expected to continue into the future. Plenty of skilled and

⁴“Vision 2010” by Pakistan Telecom Authority 2007.

cheap labor is available in Pakistan, and all other factors of input of doing business are also quite attractive compared to the region. Further it has revealed in a primary survey conducted in March, 2007 that about 20% of mobile users change their hand set thrice a year while a similar percentage of mobile users change the mobile handset once a year. The survey also found that 20% user change the mobile handset after every two years⁵. This indicates that Pakistan is a lucrative market for manufacturers of mobile handsets and other telecom equipment and this could be a successful business model.

Strategic location of Pakistan is also an added advantage. The potential investors can also target other emerging and developing economies in the region by exporting handsets/ equipment from Pakistan to provide better economies of scale. The potential investors may also explore public private partnership in such adventures.

Figure - 3
Number of Times Handsets Changed



Investment in Telecom Sector

PTA has created a conducive and investor friendly environment in the telecom sector by awarding licenses in a fair and transparent manner. All operators (mostly foreign) are rolling out their networks rapidly all over the country, which requires huge investments. After liberalization of the sector, a large number of firms are working in Pakistan's telecom sector. Some of them are laying Optical Fiber all across the country while some have laid undersea cable.

Table - 3
Investment in the Telecom Sector

Service	2004-05	2005-06	2006-07
Cellular Mobile	1,158.1	1,420.9	2,718.7
Fixed Line	2.3	0.3	746.9
LDI	35.1	50.5	602.7
WLL	277.3	259.4	40.5
Total	1,472.8	1,731.1	4,108.8

Telecom companies have invested over US\$ 8 billion during the last four years in Pakistan particularly the mobile sector whose investment share accounts for 73%. In 2006-07, Cellular Mobile sector has invested over US\$ 2.7 billion, which becomes about 66% of total investment by the sector. Local Loop segment of the industry is also taking off and in 2006-07 about US\$ 7.8 million were invested by this sector. LDI operators have invested about US\$ 603 million in 2006-07 which is about 15% of the total investment by the sector.

It is expected that the trend of investment may continue in the next 5 years because large potential market still exists in Pakistan and all operators intend to grab their share. China Mobile acquired Paktel which has contracted out US\$ 500 million worth of project to renowned companies like Ericsson, ZTE and Alcatel to roll out their networks. Similarly Mobilink also planned to invest

⁵Socio Economic Impact of Cellular Mobile Growth in Pakistan" Study by TEACH (Pvt) Limited for PTA (2007)

US\$ 500 million in 2007-08 for improvement of quality of service and infrastructure expansion. Wateen Telecom which has already laid out 5,400 Km of optical fiber all across the country has announced to invest US\$ 600 million in next two years to improve its infrastructure. Telenor plans to invest US\$ 750 million in the next two years.

Foreign Direct Investment in Telecom

Telecom sector has emerged as the largest recipient of Foreign Direct Investment (FDI) in Pakistan during the last few years. Liberalization and competition in the sector has compelled many companies to expand their infrastructure across the country, which requires more investment from foreign sources. In the last 2-3 years the telecom sector has attracted record inflows of FDI. During 2005-06, telecom sector received over US\$ 1.8 billion FDI and emerged as the only sector of the economy to attract such huge investment where its share in total FDI crossed 54%. During 2006-07, telecom sector has received above US\$ 1,824 million FDI, which was about 35% of total FDI in the country.

Table - 4
FDI Share (%) by Major sectors

Sector	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Textiles	3.8	3.3	3.7	2.6	1.3	1.2
Oil & Gas Explorations	55.3	23.4	21.3	12.7	8.9	10.6
Power	7.5	4.1	1.5	4.8	9.1	3.8
Telecommunications	1.2	1.7	21.8	32.4	54.1	35.6
I.T. Services	0.5	0.5	0.6	0.6	0.7	1.2
Financial Business	0.7	26.0	25.5	17.7	9.3	18.2

Source: State Bank of Pakistan, 2007

Telecom sector has attracted about 17 - percentage points more FDI than the financial sector and 25-percentage point more than Oil & Gas sector in 2006-07. Both of these sectors used to get more inflows of FDI a few years back. Similarly, IT & Textile sectors each received 1.2% of total FDI share in 2006-07.

Acquisitions in the Telecom Sector

Mergers and acquisitions can better serve the global customers and enhance the profits of companies who acquire the other companies. During the last four years Pakistan's telecom sector has experienced unprecedented changes with respect to technology, regulation and growth. The liberal FDI policy by the Government of Pakistan and deregulation and privatization of the sector has triggered a wave of international acquisitions in the sector. During the last year about US\$ 2 billion worth of acquisitions were made in the telecom sector.

It is viewed that stiff competition, squeezing profit margins and lack of investment resources have forced some players in the industry to rethink whether to go on their own thus convincing them to offer their shares to other players who can invest more and heavily and introduce innovation with their experience. Renowned companies from Gulf and East Asian region within depth experience in telecom sector are looking at Pakistan as a lucrative market to invest who have purchased shares in different telecom companies worth US\$ 1.7 billion. Orascom from Egypt already owning the majority stake in the leading cellular mobile operator of Pakistan (Mobilink) has purchased the

remaining 11.31% shares of Mobilink from the local partners for US\$ 290 million. China Mobile which is the largest cellular mobile operator in the World also made its first international venture by acquiring 100% shares of Paktel from Millicom and the local partner for US\$ 477 million. Similarly Warid Telecom has sold about 30% of its shares to Singtel, a well-reputed company of Singapore. Pakistan Telecom Authority, has facilitated these developments and is taking steps for further growth of the sector. PTA is however, vigilant to ensure that no cartels or monopoly situation is created that can harm competition. These acquisitions by international players show investors' confidence in the policies of the government of Pakistan, which has also been stated openly and publicly by them in various meetings and events.

Table - 5
Acquisitions in the Telecom Sector

Foreign Companies who acquired shares	Local Companies who sold shares	Share acquired (%)	Amount paid US\$ Million
Singtel, Singapore	Warid	30%	758
China Mobile, China	Paktel	100%	477
Orascom, Egypt	Mobilink	11.31%	290
Qtel, Qatar	Buraq	75%	12.3
Oman Telecom, Oman	World Call	60%	220
Source: Various Press Reports			

Apart from international acquisitions, there are some local acquisitions where leading companies have taken over some small companies. Mobilink has purchased Zarco which has WLL license for Faisalabad and Lahore regions having frequency of 3.5 GHz. Similarly, it has also purchased Dancom Online which also has frequency of 3.5 GHz all over the country. Besides, a small ISP WOL has also been purchased by the subsidiary of Mobilink.

Employment in the Telecom Sector

The telecommunications sector in Pakistan has undergone a considerable transformations following the award of two new mobile licenses, FLL and WLL licenses and privatization of PTCL, the incumbent. Stiff competition among operators to grab the market share has compelled operators to roll out their infrastructure rapidly, which has created huge employment

Table - 6
Contribution to Employment from Mobile Value Chain

Employment Impact	Number of Employees (Direct)	Number of employees including Multiplier
Mobile Network Operators	8,779	8,779
Fixedline operators	11,201	15,681
Network Equipment Suppliers	4,109	5,753
Other suppliers of Capital items	1,625	2,275
Handset dealers	3,933	5,507
Support Service providers	1,700	2,379
Airtime, SIM card and Handset retailers	123,111	172,356
Total	154,495	212,731
Source: "SIM Activation Tax and Mobile Telecommunications in Pakistan", Report by Deloitte, 2007		

opportunities (direct and indirect). It is estimated that about one million job opportunities have been created since the liberalization of the sector in 2003. The mobile companies alone had over 9,500 employees in 2006-07, which is 20% higher revenue than the last year. Telecom sector (mobile and Fixed line) has about 84,000 employees directly on their payroll in 2006-07. However, the sector has vast linkages with all other sectors where it is producing large employment opportunities such as civil work for installation of towers, support service providers, Airtime, SIM and hand set retailers, employment in fixedline (due to mobile sector) and network equipment suppliers etc.

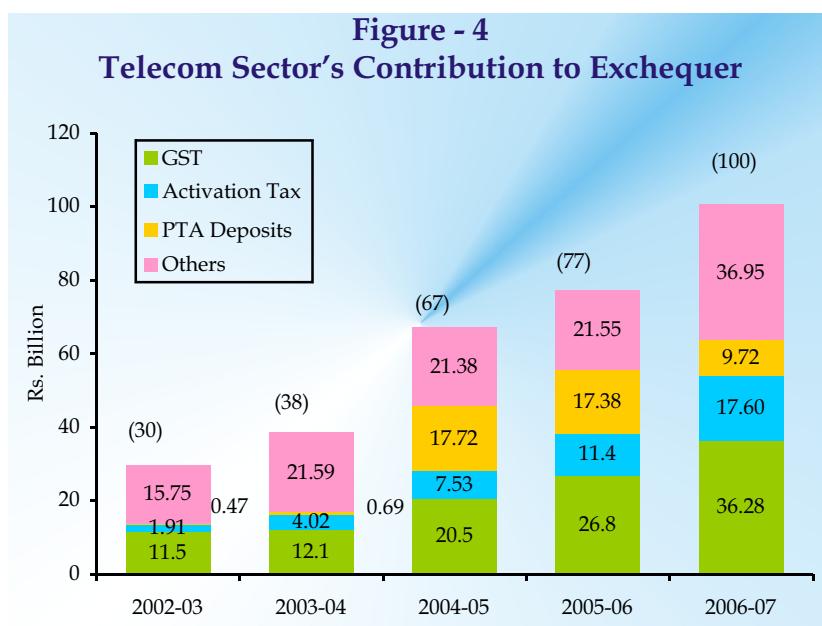
Deloitte has estimated that so far about 212,000 employment opportunities (direct and indirect) have been generated countrywide only by the mobile sector. A study conducted by TEACH has estimated that Cellular Mobile sector has generated about 743,025 employment opportunities which include direct, indirect and induced employment in linked sectors of the economy. Study further revealed that about 260,000 employment opportunities have been generated by other segments of the telecom sector including WLL, LDI, card payphones and other new players.

Taxes on the Telecom Sector

Telecom sector is a major contributor in generating revenues for the Government in the form of taxes, duties and regulatory charges. To generate adequate level of revenues government is undergoing large tax reforms which include broad based tax policy and tax administrative reforms which aimed to reduce indirect taxes that are considered regressive taxes. During the year 2006-07, Telecom sector contributed Rs. 36.3 billion in the form of sales tax which was 27% of total domestic GST collection by CBR and 9% of total indirect tax collection. Telecom share in the indirect taxes is increasing tremendously over the years. In 2005-06 sales tax collection from telecom sector was Rs. 27 billion which rose by about 35% in just one year. Five years back, government collected only Rs. 11 billion from telecom sector in the form of GST.

During 2006-07 total revenue collected by the Government in the form of taxes and Regulatory fee was more than Rs. 100 billion which is about 30% higher than the last year. Indirect tax in the form of GST/CED has the major share in total government collection from telecom sector which was

Rs. 26 billion in 2005-06 and its share in total was 34%. In 2006-07 Government collected Rs. 36.3 billion GST from the telecom sector and its share in the total telecom taxes has increased to 36%. It implies that telecom usage has increased tremendously due to low tariffs and other steps taken by the regulator and the government. Government also collects activation tax on new mobile



connections @ Rs. 500. In 2006-07, CBR collected Rs. 17.6 billion under this head which is 54% higher than last year.

However, analysts are of the view that the CBR and various local governments & civic authorities are levying exorbitant taxes and charges such as Rs. 500 Activation Tax on every new mobile connection, 10% Withholding Tax on prepaid calling cards and post psid accounts, and 15% Federal Excise Duty (FED) on Fixed Wireless Terminal (FWT) equipment for WLL which is a hurdle for further growth of the

sector. Rationalization of taxes is required in the sector. In 2006-07, Cellular Mobile companies deposited Rs. 17.3 billion in the form of Withholding tax which is an advance income tax credit for which can be taken by a user from the tax authorities at the time of filing his/her Income Tax return. However, mostly users are not liable to pay income tax. Hence, they can not get the credit of this withholding or advance tax. Hence, imposing this tax on prepaid mobile cards is completely unjustified. Similarly, Cellular mobile companies deposited over Rs. 17 billion as an activation tax of which 66% activation tax has been paid by two companies Mobilink and Telenor which are the fastest growing companies in the sector. If this tax is reduced, they would have more resources to expand their services in the rural areas of Pakistan. Analysts believe that reduction in activation tax is unlikely to lead to decrease in government tax revenues. It is estimated that if government reduces the amount of activation Tax to Rs. 250, tax collection from cellular mobile sector will increase by about 32% in just one year⁶.

Telecom Revenues

Due to substantial increase in the telecom traffic due to lower tariffs and vast coverage of cellular mobile operators and WLL operators, the revenues of telecom companies have shot up in 2006-07 although Average Revenue Per User (ARPU) of cellular mobile sector has dropped to about US\$4.

Figure - 5
GST/CED Collection from the Telecom Sector
(% Share in Total)

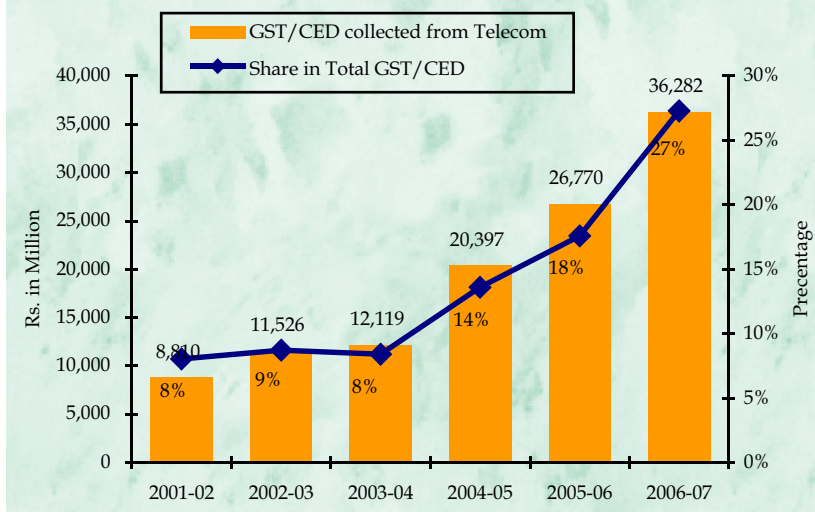
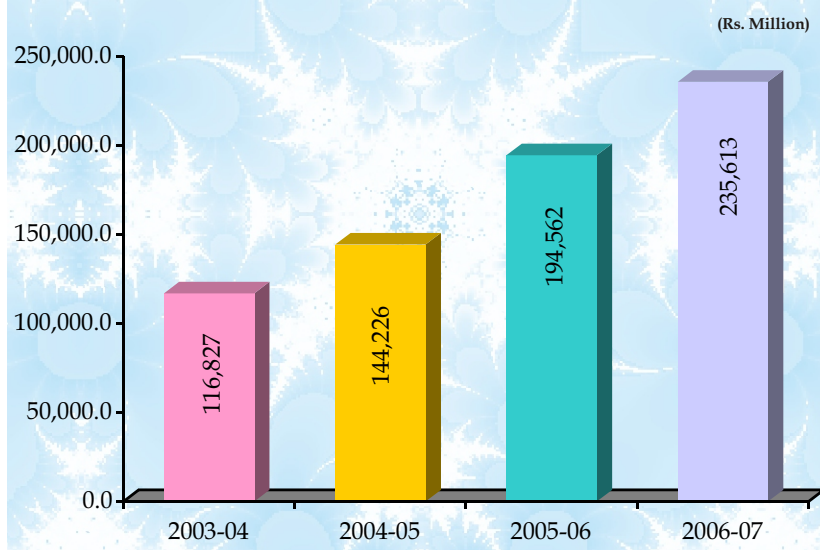


Figure - 6
Telecom Revenues



⁶SIM Activation Tax and Mobile Telecommunication in Pakistan, Report by Deloitte 2007

Total revenues of telecom sector in 2006-07 grew by about 21% compared to the last year. However, this increase is over 100% if we compare current revenues with the revenues of 2003-04. Cellular Mobile sector share in total telecom revenue was about 57% in 2006-07 which was just 24% four years earlier. Total Mobile sector revenues have increase by 378% during the last four years. LDI segment (new companies) of the sector contributed about 7% revenue in total telecom revenues in 2006-07. PTCL, the incumbent operator's share in total revenues has declined from 63% in 2003-04 to 28% in 2006-07. However, overall the revenues of PTCL have declined by about 12% during the last 4 years. WLL segment's performance in terms of revenues was quite impressive in 2006-07 whereby it contributed about 1.1% in the total revenues in 2006-07. Earnings of only three WLL companies were over Rs. 2.6 billion in 2006-07 while three years back their revenue was just Rs. 274 million.

Market Potential⁷

Currently, there are more than 68 million mobile and fixed line subscribers, which are almost 43% of the total population. In recent years, telecom subscribers have grown tremendously especially in the cellular mobile sector which has left many analysts in wonder as the trend seems to reflect an enhanced standard of living or perhaps the increase in the purchasing power of the common man who now carries a cell phone. Currently we have a population of over 161 million and if we exclude approximately 20% relatively extreme poor population and 20% children (population below the age of 8 years), we get a potential target market of about 97 million people. It is however, widely argued that poor are more inclined to avail telecom facility which in turn increases their income while reduces their business input costs, and in that case potential target market increases to more than 110 million people. So far cellular mobile companies have grabbed only 63 million of this potential target market, which is only 61% of the potential target market. If we exclude 10% users who have multiple sims then Cellular mobile operators access come to only 55% of the target market. Similarly the Fixed line operators including WLL have covered only 6.6% of the potential population. This potential market is projected to cross 100 million in vision 2010 report of PTA. As about 66% of the potential population in Pakistan is living in rural areas, the scenario provides a huge market potential for WLL and cellular operators due to their easy deployment. Hence, there exists a promising scenario for the existing and new telecom entrants, which get more, reinforced with further expansion in the national economy.

Conclusion

Telecom sector is growing at an astounding pace where all stakeholders are getting due benefit out of it. Digital divide is bridging at a faster pace particularly with the start of USF roll-outs and wireless based services in particular are reaching out to remote areas of the country very rapidly. The sector is contributing about 2% in GDP directly and if we include its indirect contribution in other sectors of the economy this share comes to about 5%. Telecom revenues are on the rise and the sector continued to attract a major portion of foreign investment.

⁷“Vision 2010”by Pakistan Telecom Authority 2007.