

The Bulletin

Issue: 11

Unlocking Financial Inclusion: The Transformative Role of Digital Banking in Pakistan's Microfinance Sector

In our quarterly newsletter, we not only highlight our achievements but also highlight the global and local issues that need attention. We highlight the importance of the financial sector and how it can help the society in overcoming the challenges.

As digital banking continues to evolve, it not only transforms traditional banking practices but also sets the stage for a more interconnected and inclusive financial ecosystem. This newsletter underscores the pivotal role of technology in shaping the future of banking and underscores the need for continuous innovation to meet the evolving needs of customers in a digital-first world.

We welcome your feedback. Our hope with this newsletter is to build a community of engaged readers interested in sincere discourse about the challenges and opportunities we face as a sector, the disruptions (technological or otherwise) required to serve our customers better and build an inclusive Pakistan.

Yours sincerely,
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Background

Pakistan, like many developing nations, grapples with the challenge of financial inclusion. Millions of its citizens, particularly those in rural and underserved areas, remain excluded from formal banking systems, unable to access basic financial services that could uplift them from poverty. Commercial banks are generally reluctant in extending loans to this segment due to non-availability of formal documentation. This market is highly volatile due to its dependencies on natural calamities. However, amidst these challenges, a beacon of hope emerges – the synergy between microfinance institutions and digital banking technologies.

In the late 1980s and into the 1990s, the State Bank of Pakistan recognized the pivotal role of the microfinance sector in addressing poverty issues within the country. Realizing its potential, SBP began actively supporting initiatives geared towards microfinance. A significant milestone was reached in 1989 with the establishment of the Pakistan Poverty Alleviation Fund (PPAF), aimed at providing crucial funding and support to non-governmental organizations (NGOs) involved in microfinance activities. As the 1990s progressed into the 2000s, the microfinance sector experienced a surge in

popularity and growth. NGOs expanded their microcredit operations, and an influx of new participants entered the market. This period saw a dynamic shift in the landscape of financial services, with microfinance gaining traction as a powerful tool for poverty alleviation.

The year 2001 marked a turning point with the introduction of the Microfinance Institution Ordinance, which provided a regulatory framework for the sector. This paved the way for the emergence of microfinance banks, enabling them to operate within a structured legal framework. With this newfound legitimacy, microfinance banks rapidly expanded their operations and product offerings, responding to the evolving needs of their clients.

Furthermore, the advent of technology played a transformative role in the microfinance sector. Microfinance banks embraced technological innovations, leveraging them to enhance their efficiency and outreach. By incorporating technology into their operations, these institutions not only streamlined their processes but also extended their reach to underserved communities, thereby bolstering financial inclusion efforts.

Challenges Faced in Traditional Microfinance Banking

Due to the target audience of microfinance sector, there has always been quite a lot of challenges when attempting to reach to the marginalized communities in Pakistan.



Introduction to Digital Banking and Its Growing Significance

The advent of digital banking platforms and services has sparked a transformative shift in the dynamics of financial interactions for both individuals and businesses. This revolution is characterized by an unprecedented level of convenience, accessibility, and efficiency. These platforms capitalize on technological advancements, particularly the widespread adoption of the internet and mobile devices, to offer a diverse array of financial services that can be accessed anytime and anywhere.

Beyond mere paperless transactions or swift processing, digital banking embodies a comprehensive approach to enhancing customer service and delivering superior services with heightened efficiency. It encompasses a broad spectrum of offerings, ranging

from basic banking transactions to sophisticated investment opportunities, all tailored to cater to the evolving needs of consumers in our increasingly interconnected world.

The evolution towards digital banking is not merely a trend but a global shift in the business model of financial institutions. Institutions worldwide are actively transitioning towards digital frameworks to optimize their operations and better serve their clientele. While challenges persist, particularly in underdeveloped or developing countries where literacy rates and financial literacy levels may be lower, the momentum towards digitalization remains strong, driven by the pursuit of improved service delivery and operational efficiency.



Importance of Financial Inclusion

Empowering Individuals

Financial inclusion represents a pivotal mechanism for empowering individuals, particularly those residing in marginalized communities, by equipping them with the necessary tools to effectively manage their finances. Through access to essential financial services such as credit, savings, insurance, and payment facilities, financial inclusion facilitates the smoothing of consumption patterns, enables investments in education and healthcare, and facilitates asset accumulation, thereby facilitating upward socio-economic mobility and financial enablement.

Catalyst for Entrepreneurship

The provision of financial services acts as a catalyst for entrepreneurship and the development of small businesses, thereby stimulating economic growth and employment generation. By facilitating access to capital, market opportunities, and productive assets, financial inclusion nurtures innovation, enhances productivity levels, and contributes to overall economic dynamism.

Navigate Unexpected Adversities

Individuals and households that are financially included are better

positioned to navigate unexpected adversities such as illness, natural calamities, or economic downturns. Access to savings mechanisms and insurance coverage serves as a buffer against risks, enhancing resilience levels and mitigating vulnerabilities, thus preventing households from spiraling into cycles of poverty.

Fosters Social Cohesion and Stability

The promotion of financial inclusion fosters social cohesion and stability within communities and societies by reducing economic disparities and promoting inclusivity. Access to financial services cultivates a sense of belonging and participation in the formal economy, thereby diminishing social tensions and fostering harmonious coexistence.

Catalyst for Comprehensive Socio-Economic Development

Ultimately, financial inclusion transcends mere access to financial services; it serves as a catalyst for comprehensive socio-economic development, poverty alleviation, and inclusive growth. By empowering individuals, facilitating economic opportunities, and enhancing resilience, financial inclusion lays the groundwork for the establishment of more inclusive and sustainable societies.

Adoption Trends in Pakistan Financial Landscape



In recent years, Pakistan's financial landscape has undergone a notable metamorphosis, spurred by rapid advancements in technology and evolving consumer preferences. The realm of mobile and internet banking transactions, in particular, has experienced remarkable growth, with an annual surge of 57% in volume and 81% in value. (source: SBP) Similarly, e-banking transactions conducted through traditional banks and Microfinance Banks (MFBs) expanded by 29% in volume and 21% in value over the fiscal year, while Branchless Banking (BBs) transactions displayed a parallel trajectory, witnessing a 28% increase in volume and a notable 45% uptick in value during FY23.

This surge in digital banking transactions coincided with a significant rise in the number of users across various electronic banking channels. Notably, internet banking users surged by 15%, mobile banking users by 30%, and BB mobile app users by 42% over the year. Electronic Money Institutions (EMIs) played a pivotal role in enhancing digital banking inclusion, having facilitated the opening of over 2 million e-wallets since their inception. The allure of e-banking lies in its efficient and instantaneous payment solutions, which have contributed to its steady growth over the years, contrasting with the declining trend observed in paper-based transactions, which experienced a cumulative decrease of around 20% over the past five years, albeit with a 20% increase in value during FY23.

Concurrently, financial institutions are bolstering their e-banking infrastructure to cater to the burgeoning demand, expanding Point-of-Sale (POS) terminals, Automated Teller Machines (ATMs), Cash/Cheque Deposit Machines (CDMs), and the network of ecommerce merchants and agents. As of June 30, 2023, there were 115,288 POS terminals, 17,808 ATMs, 520 CDMs, and 6,889 ecommerce merchants facilitating payment services for customers. Transactions through POS and ATMs experienced annual growth rates of 45% and 17%, respectively, during the fiscal year. Domestic e-commerce transactions utilizing payment cards totaled 31.8 million, amounting to PKR 142 billion during the period. As of June 30, 2023, there were 58.1 million payment cards in circulation, with 44.5 million issued by banks and MFBs, 10.8 million by branchless banks, and 2.8 million by EMIs.

Source:

<https://www.sbp.org.pk/press/2023/Pr-27-Sep-2023.pdf>

Mobile Penetration and Branchless Banking

Pakistan has witnessed a widespread proliferation of mobile phones, particularly smartphones, laying a robust foundation

for the uptake of mobile banking services. The popularity of mobile banking apps and USSD-based banking solutions has surged, empowering users with convenient access to financial services on the move.

Branchless banking services, encompassing mobile wallets and agent assisted banking networks, have garnered significant traction across Pakistan, particularly in rural and underserved regions. These services facilitate basic financial transactions, including cash deposits, withdrawals, and transfers, through authorized agents or mobile platforms, enhancing financial accessibility for remote communities.

Government Initiatives

The Government of Pakistan has embarked on several initiatives aimed at bolstering financial inclusion and digital payments. Efforts such as the National Financial Inclusion Strategy (NFIS) and the implementation of the Raast Instant Payment System are geared towards broadening access to financial services, fostering digital payments, and streamlining financial transactions for enhanced efficiency.

Fintech Innovation

The advent of fintech startups and innovative digital banking solutions has injected dynamism and competition into Pakistan's financial landscape. Fintech firms are leveraging cutting-edge technology to address specific pain points such as credit accessibility, financial literacy, and remittance services, thereby extending the reach of financial services to traditionally underserved segments of the population.

Digital Payments

The adoption of digital payment solutions, including QR code payments, mobile wallets, and online payment gateways, has surged with the burgeoning e-commerce sector and evolving consumer preferences. Digital payment platforms offer convenience, security, and speed, presenting a compelling alternative to traditional cash-based transactions.

Regulatory Framework

The State Bank of Pakistan (SBP) has assumed a proactive stance in shaping the regulatory landscape governing digital banking and fintech innovation. Regulatory initiatives such as the Electronic Money Institutions (EMI) Regulations and the Digital Financial Services (DFS) Policy Framework are designed to foster innovation, safeguard consumer interests, and fortify financial stability within the digital banking ecosystem.

The trajectory of digital banking adoption in Pakistan is marked by a confluence of factors including technological innovation, regulatory facilitation, and evolving consumer behavior. As digital banking continues to evolve, it holds the promise of extending financial inclusion, propelling economic expansion, and fortifying the overall efficiency and resilience of Pakistan's financial infrastructure.

Empowering Entrepreneurs and Small Businesses and Women

The integration of digital banking within microfinance institutions has proven to be a transformative force in empowering women and small-scale entrepreneurs through various channels:

Enhanced Accessibility

Digital banking obviates the necessity for physical presence at a bank branch, thereby rendering financial services more accessible to women and small business owners who may encounter mobility constraints owing to cultural or familial responsibilities. Leveraging smartphones or computers, they can now conveniently conduct banking transactions from the comfort of their homes or workplaces.

Promoting Financial Inclusion

Microfinance banks harness digital banking to extend their reach to underserved demographics, including women and small business proprietors residing in remote or rural locales. By affording them access to fundamental banking amenities such as savings accounts, loans, and insurance via digital platforms, these institutions foster financial inclusivity and empower individuals hitherto marginalized from formal financial avenues.



Convenience and Efficiency

Digital banking furnishes a more convenient and efficient modality for managing finances vis-à-vis traditional banking mechanisms. Women and small-scale entrepreneurs can seamlessly execute various transactions – be it fund transfers, bill settlements, or loan applications – sans the necessity of visiting a physical bank branch. This economizes time and effort, enabling them to allocate more resources to their business operations and other productive pursuits.



Reduction in Transaction Costs

Digital banking frequently entails diminished transaction costs in comparison to traditional modes of banking, such as cash-centric transactions or in-person visits to bank branches. This holds particular significance for small-scale entrepreneurs operating within narrow profit margins, as it curtails the overall expenditure associated with business operations, thereby augmenting their financial viability.

Financial Literacy and Empowerment Initiatives

Many microfinance banks administer financial education and literacy programs through digital conduits. By furnishing women and small-scale entrepreneurs with access to educational resources covering diverse topics like budget management, savings strategies, and entrepreneurial skills, these establishments empower them to make judicious financial decisions and proficiently administer their business and personal finances.

Promoting Financial Literacy

Digital banking in microfinance banks is promoting financial literacy in Pakistan through several key avenues

1. **Online Educational Resources:** Microfinance banks leverage digital platforms to provide access to educational materials and resources on financial literacy. These resources include articles, videos, interactive tutorials, and webinars covering topics such as budgeting, saving, investing, and entrepreneurship. By making these resources easily accessible through their websites or mobile apps, microfinance banks empower individuals to learn at their own pace and improve their financial knowledge.
2. **Financial Literacy Campaigns:** Microfinance banks conduct digital financial literacy campaigns aimed at raising awareness and educating individuals about basic financial concepts and best practices. These campaigns may include social media outreach, email newsletters, SMS alerts, and online workshops targeting specific demographics, such as women entrepreneurs or small business owners. By leveraging digital channels,

microfinance banks reach a wider audience and engage with individuals across different geographical locations.

3. **Interactive Tools and Simulators:** Some microfinance banks offer interactive tools and financial calculators on their digital platforms to help users understand various financial concepts and scenarios. For example, users can use loan calculators to estimate monthly loan payments or savings calculators to set financial goals and track progress over time. By providing these interactive tools, microfinance banks make financial education more engaging and practical for individuals.
4. **Personalized Financial Advice:** Digital banking platforms may incorporate features that provide personalized financial advice and recommendations based on user preferences, behavior, and financial goals. For example, users may receive targeted recommendations on saving strategies, investment options, or debt management techniques tailored to their specific needs and circumstances. By offering personalized advice through digital channels, microfinance banks help individuals

make informed financial decisions aligned with their long-term objectives.

5. **Partnerships and Collaborations:** Microfinance banks often collaborate with government agencies, non-profit organizations, educational institutions, and other stakeholders to promote financial literacy initiatives through digital channels. These partnerships may involve joint awareness campaigns, co-developed educational content, or shared resources to reach a broader audience and maximize impact. By working together, stakeholders can leverage each other's expertise and resources to address the financial literacy gap more effectively.

Overall, digital banking in microfinance banks plays a crucial role in promoting financial literacy in Pakistan by providing access to educational resources, conducting awareness campaigns, offering interactive tools, providing personalized advice, and fostering collaborations with other stakeholders. These efforts help empower individuals with the knowledge and skills they need to make sound financial decisions and improve their financial well-being.

U Bank's Role in Promoting Digital Banking

Driven by the passion for disruptive innovation and the desire for financial inclusion, we aim to become the problem solver and enabler to Pakistani microfinance ecosystem



U Microfinance Bank, has been playing a pivotal role in promoting digital banking in Pakistan, particularly in the microfinance sector with its extensive network of over 375 branches and more than 55,000 UPaisa agents.

By reaching out to the unbanked segments of society, the bank is not only providing access to financial services but also empowering individuals to participate actively in various economic sectors such as agriculture, farming, retail, and the salaried workforce. This strategic approach aligns with the broader national agenda of promoting financial literacy, financial inclusion and enhancing economic opportunities for all citizens.

U Bank has made significant progress in advancing digital banking within Pakistan's microfinance sector. From introducing mobile apps and branchless banking to fostering partnerships with fintech companies and boosting digital literacy, U Bank is dedicated to utilizing technology to offer accessible, efficient, and secure financial services. Moreover, the bank is poised to

introduce Islamic banking principles-based services, broadening its range of offerings to cater to diverse customer needs. As it continues to integrate advanced technologies and enhance its digital portfolio, U Bank's vision promises to revolutionize the banking landscape in Pakistan.

U Bank is already providing branchless banking solutions, tailored to businesses of varying sizes, including small enterprises and large corporations. These encompass a range of digital services, such as a dedicated corporate portal and digital platforms facilitating smooth salary disbursement and funds/bills collection. With U Bank's existing suite of services, businesses benefit from unparalleled convenience, flexibility, and reliability in managing their financial transactions. Leveraging U Bank's branchless banking solutions, companies can streamline operations, enhance efficiency, and concentrate on core activities, all while ensuring secure and convenient fund management.

Current Initiatives

DLA – Digital Loan Application

This Digital Loan Application (DLA) streamlines the loan application process by leveraging digital platforms. By digitizing the process, the bank ensures efficiency and timely processing of loan applications, thereby enhancing customer experience and reducing turnaround times. This technological advancement not only expedites the application process but also minimizes paperwork, streamlining operations for both for the bank and its customers.

HRA

UPaisa has recently introduced the HRA account opening functionality where beneficiary can register themselves and receive remittance directly in to their accounts as per prescribed limits. The account can be used for conducting banking activities as well.

QRM P2P

This Eid, U Bank had facilitated with awareness/financial literacy, account opening and QR payment facilitation to cattle traders as per SBP cashless and QR payment initiative. All banks were mandated and allocated cities/markets for this activity by SBP. Pictures/artwork available if required.

Technology leverage with our group

Technology will primarily be used to operational efficiency in the banking sphere. This will also enable & invigorate the financial inclusion under the auspices of State Bank of Pakistan. This will also create an environment for creating ease in availing banking services for the un-banked.

USSD

Users with basic phones (non-smart phones) can avail mobile banking services by using the USSD option. Also in areas where internet connectivity or coverage issue exists, USSD is a lifeline for conducting mobile banking activities. This is used by both the customers and branchless banking agents.

Enhanced Mobile App/ Internet Banking Features

By the end of 2024, U Bank will transition to the Infinity platform by Transact, significantly enhancing its digital banking capabilities. The new platform will enable more efficient operations, advanced security features, and a broader range of services, setting a new standard in the industry

Customer Education Programs

To ensure that customers can fully utilize digital banking services, U Bank is conducting digital literacy programs. These programs educate customers on the benefits and usage of digital Banking, ensuring that more people can access financial digital services.

Wallet Promotions

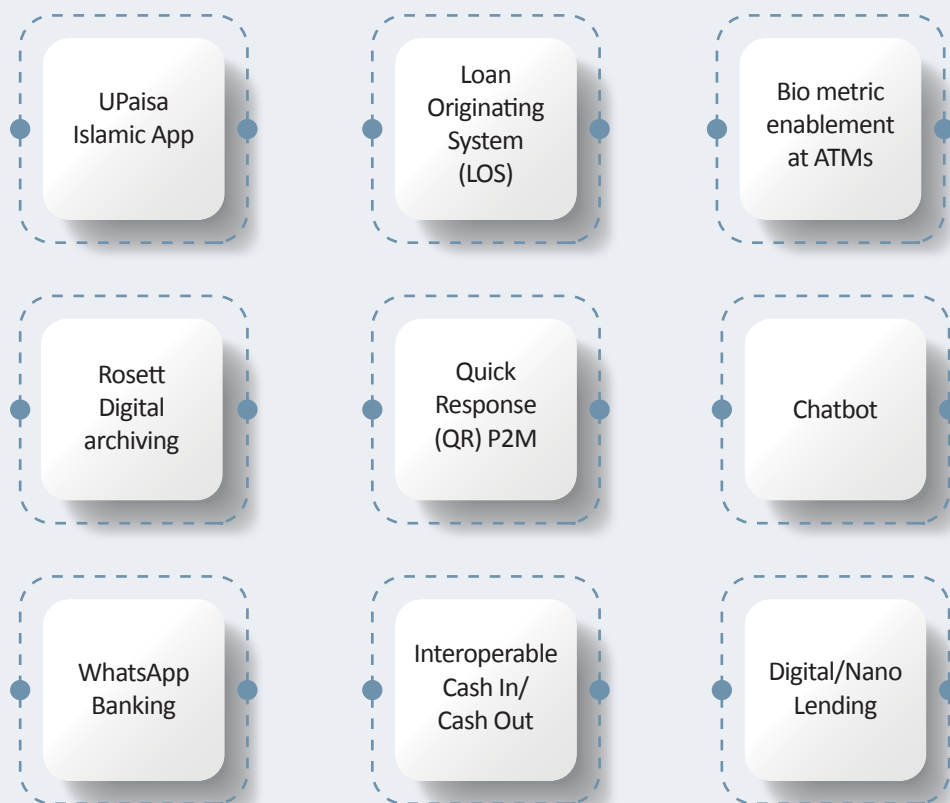
To incentivize the adoption of mobile financial services and encourage their utilization for banking purposes, a range of promotional initiatives have been implemented at different intervals. By offering incentives like cashback rewards, free minutes, discounts and exclusive offers, financial institutions aim to attract more customers to embrace mobile banking solutions for their diverse banking needs. These efforts not only empower individuals to manage their finances conveniently on-the-go but also contribute to the overall digitalization and modernization of the banking sector.



Future Initiatives

U Bank plans to expand its digital ecosystem by integrating more services into its mobile app and online platforms. This

includes more comprehensive financial products, investment opportunities, and loan services.



The future is dynamic, and U Bank will continue to innovate and adapt to stay ahead of the curve. By fostering a culture of creativity and collaboration, we will embrace emerging technologies and market trends to deliver value-driven

solutions that exceed our customers' expectations. Together with our customers, partners, and stakeholders, we will shape a future where banking is not just a service but an empowering experience that enhances lives and drives progress.

*Our Journey Towards
Becoming a Leading Digital
Bank Is Not Just About
Technology but About
Transforming the Banking
Experience for Our
Customers*

