

## PAKISTAN BANKS

# MARKET VISTA

## Digital disruptions will far outlive the virus

- The digital revolution has been painfully slow to come to Pakistan however the PTI-led Govt. has put wheels in motion and brought to fruition major initiatives capitalizing on prevalent catalysts (increased teledensity, mobile broadband penetration) to upgrade major economic pillars.
- Digital payments are the latest of these pillars to be upgraded, tying into a wider stream of initiatives already in place at SBP, with Roshan Digital Account (RDA) and now 'Raast' - an instant payment system is the latest bid to promote digitalization in the country.
- These initiatives tie into wider imperatives of FATF compliance and combatting money laundering while enhancing the tax net. In this regard, COVID related disruptions while certainly a dampener in terms of social/health costs, has accelerated digital financial services adoption via e-banking channels.
- For Banks, investments in digitalization are likely to raise upfront costs in the medium run (although much lower than previous tech adoptions) while consequent returns would be long-term in our view.
- Evolving digital lending space (HBL has begun entertaining/disbursing personal loans digitally) provide greater opportunities for the banking space to target smaller segments (and in return, yield higher returns).

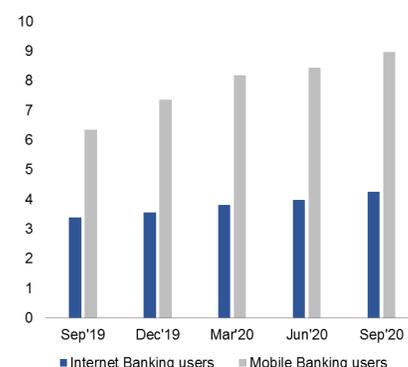
**Digitalization to drive financial inclusion:** Pakistan's financial under penetration has been a pain point for over a decade now with just over 42% of bank accounts to adult population vis-à-vis ~80% and ~47% in India and Bangladesh respectively. The PTI-led Govt has already set in motion wider policy priorities to bring about disruptions to the space, leveraging prevailing catalysts of increased digitization, Govt. initiatives to curb informal/grey transactions (the impact of which could linger for some time due to higher out-of-bank settlement of transactions). These initiatives tie into wider imperatives of FATF compliance and combatting money laundering while enhancing the tax net. In this regard, COVID related disruptions, while certainly a dampener in terms of social/health costs, has already accelerated digital financial services adoption via e-banking channels, where payment systems data indicated major uptick (Excluding online branch transactions, +53.4%YoY in 3QCY20, gaining a share of 2.6% share in total payment transactions vs. 1.5% share in same period last year). The same is mimicked by growth in deposit accounts, +10.7% in FY20 vs. avg. 7.4% growth in the previous 5y, primarily driven by 13.0%YoY growth in personal deposits which could lead to better than expected deposit growth going forward (CY21-23F: 10.2% vs. 9.3% in CY17-19).

**Development of digital system offers strong potential:** Digital Ecosystem is still developing where Pakistan lags behind regional peers as per Digital adoption index (DAI: 1.55 vs. 2.01/1.86 of India/Bangladesh). Additional benchmarks such as Cisco's Internet Readiness Index, WEF's Global Competitiveness Index indicate the relatively low-base Pakistan currently occupies on technological readiness and digital infrastructure (including quality of human capital) compared to regional peers. To highlight, teledensity in Pakistan stands at 79.6% compared to 84/102% in India/Bangladesh of which ~50% are 3G/4G subscribers. As such, only 10.5% are registered as subscribed to mobile banking services and even more lower are the internet banking users (4.7% of total broadband subscribers).

**Central bank playing an active role:** A key role has been played by the SBP in enabling the environment where starting off with waiver on fees on online transactions and topping it off with Roshan Digital Account (RDA) and now 'Raast' - an instant payment system are some of the measures of SBP in promoting digitalization in the country (see timeline for major events). Crucial aspects which need to be addressed for improving adoption and utility amongst existing (and prospective) customers, in our view, are to ensure cost competitiveness (low transaction costs) and linkages to a comprehensive identity stack (ideally NADRA database). To note, we expect the relatively robust private FinTech ecosystem (including commercial bank payment

Hamza Kamal  
hamza.kamal@akdsecurities.net  
111-253-111 Ext:634

*Offsite banking gaining acceptance post COVID (mn users)*



Source: SBP & AKD Research

*Digital onboarding increases transaction volume & Value*



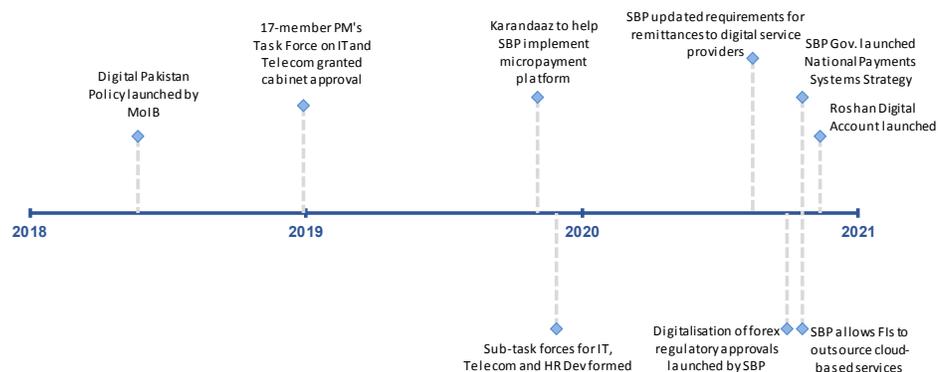
Source: SBP & AKD Research



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platforms) to build front-end applications for end users, maximizing gains from digital financial services establishing these platforms as profitable platform in their own right, a catalyst seen embodied in availability of early stage funding (domestic startups raised US\$57.7mn in 2020 compared to US\$47.7mn in CY19 through VC funds from data collected by i2i ventures tracker).

## Timeline of digital initiatives



Source: AKD Research

**Investments in digital infrastructure to keep costs elevated in the short term:** Investments in digitalization could ramp up costs of the banking sector in the medium run while consequent returns would be long-term in our view. Moreover, developments on financial digitalization have been concentrated in end-to-end payment gateways which should result in a shift in fee drivers however, we do not see any material structural change in cost structures in the banking space in the medium run. Evolving digital lending space (HBL has begun entertaining/disbursing personal loans digitally) provides greater opportunities for the banking space to target smaller segments and in return yielding higher returns.

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- Equity & Asset return based methodologies (EVA, Residual Income etc.)

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**AKD Securities Limited**  
602, Continental Trade Centre,  
Clifton Block 8, Karachi, Pakistan.  
research@akdsecurities.net