



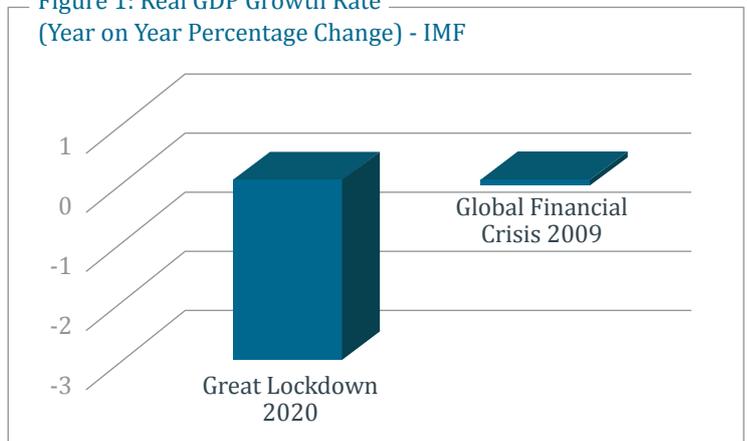
Industry Note: COVID 19 and its Impact on Pakistan's Digital Financial Services Landscape

Background

COVID 19, a new coronavirus disease, was first identified in Wuhan, China in January 2020. This has resulted in slow business activity throughout the world, indicating a global recession¹. The global scenario is still evolving, where lockdowns in some countries are stronger than others². The economic and financial impact is likely to be varied in different countries, primarily depending on their respective strategies to respond to COVID 19. However, all major multi and bilateral institutions have come up with some form of evaluations to measure the impact of COVID 19 on the global economy.

The International Monetary Fund (IMF) is predicting a negative (-3) global growth in 2020³. (Figure 1). The World Bank conservative estimates suggest that GDP will decrease by 2 percent for the global economy and by 2.5 percent for developing countries. In a more elaborate estimate, the World Bank suggests an almost 4 percent decrease in global GDP (Detailed Table in Annexure A). The Asian Development Bank (ADB) estimates regional growth (developing Asia) at 2.2 percent, a decrease by almost 3.3 percent as compared to estimates of growth provided in September 2019 (5.5 percent).

Figure 1: Real GDP Growth Rate (Year on Year Percentage Change) - IMF



The global recession is likely to have an accentuated impact on low- and middle-income countries, including Pakistan⁴. As more people are employed under vulnerable employment, and lesser Small and Medium Enterprises (SMEs) are linked to the formal financial sector, the ability to respond to the impact will also be weaker. The ADB estimates that economic growth in Pakistan is expected to slow down to 2.6 percent this year, before recovering to 3.2 percent in 2021. Similarly, the Pakistan Institute of Development Economics (PIDE) estimates Pakistan's GDP impact to be a 2.3 percent decrease in a more conservative scenario and 4.6 percent decrease in a more sustained and stricter lockdown.

However, all estimates provided are dependent on how the situation, globally, and in Pakistan, unfolds. Given the recent decisions by the Government of Pakistan (GoP) on easing restrictions for a few sectors of the economy, the overall impact is anticipated to be lesser than originally projected. Pakistan's efforts in containing the spread of COVID 19 have been widely appreciated and seem robust. However, Pakistan, being a developing and largely informal economy, faces a difficult choice between a complete lock down (which will exponentially impact businesses, employment and poverty), or a partial lock down (where impact on businesses, employment and poverty is moderate).

The Digital Financial Services Ecosystem

Amidst the lockdowns and widespread social distancing, Digital Financial Services (DFS) are being favored as the preferred mode of financial transactions as they resonate with the precautions necessary

¹ <https://www.bloomberg.com/news/articles/2020-03-17/morgan-stanley-economists-say-global-recession-now-base-case>

² <https://www.theguardian.com/world/2020/apr/19/israel-and-south-korea-to-ease-coronavirus-lockdowns>

³ <https://blogs.imf.org/2020/04/14/the-great-lockdown-worst-economic-downturn-since-the-great-depression/>

⁴ <http://documents.worldbank.org/curated/en/295991586526445673/pdf/The-Potential-Impact-of-COVID-19-on-GDP-and-Trade-A-Preliminary-Assessment.pdf>

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during the outbreak of COVID 19. The SBP has also recently taken measures to support the digital financial ecosystem through promotion of DFS. The following guidance has been issued by the SBP for DFS:

- a. Banks/MFBs shall waive the transaction charges on RTGS customer transfers
- b. Banks/MFBs shall waive all charges for customers using their online fund transfer services including intra and interbank funds transfer (IBFT)
- c. Fee earned on all utility bill payment services to be shared equally between Banks/MFBs and respective PSOs
- d. Banks/MFBs/PSO/PSPs to make urgent arrangement for:
 - I. Enabling Digital Challan Collection
 - II. Offer Loan repayment facility through digital channels
- e. Biometric verification for customers to activate internet and mobile banking is suspended

These measures may provide a significant opportunity for the DFS ecosystem in Pakistan to accelerate adoption and utilization of DFS channels. Other initiatives being undertaken by the Government and Digital Financial Service Providers (DFSPs) include:

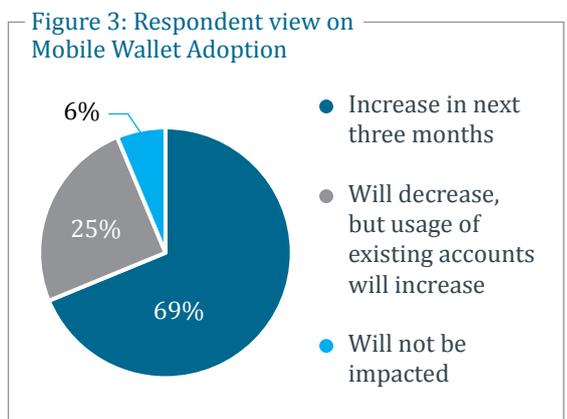
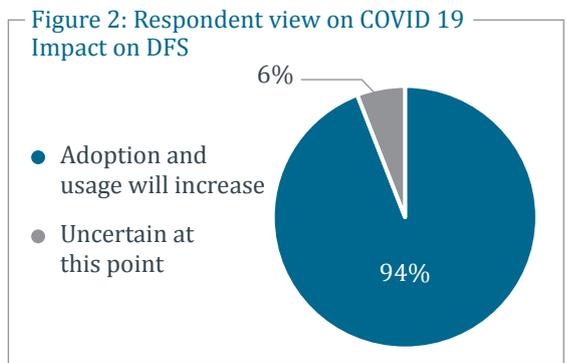
- a. A large Government to Person (G2P) funds transfer scheme (using the Ehsaas PMT Score methodology) has been planned, to transfer PKR 12000 to 12.5 million households (39% of total households in Pakistan). This will support approximately 67 million people in Pakistan, disbursing a total of PKR 150 billion. The funds will be disbursed through POS of DFSPs and through direct Bank branches, after Bio-Metric verification⁵.
- b. Zakat disbursement is also being undertaken through digital channels. In April 2020, EasyPaisa has partnered with the Zakat and Ushr department of the Government of Punjab to disburse zakat funds digitally to around 170,000 households, totaling PKR 1.5 billion in funds.

Covid- 19, A Catalyst for High Adoption and Increased Usage

Given Karandaaz’s unique positioning in the DFS ecosystem, Karandaaz undertook a survey of 17 DFSPs and 8 Fintechs across the country to understand the impact of COVID- 19 on the DFS ecosystem in Pakistan.

The findings from the research indicate that 94 percent of the providers feel that adoption and usage of DFS, overall, will increase in the next three to four months (Figure 2). This might be a short-term impact, but provides a significant opportunity to influence user behaviour.

Correspondingly, 69 percent of the respondents believe the mobile wallet adoption will increase in the next three months. Whereas, 25 percent suggest that adoption might not increase, but usage by current mobile wallet subscribers will increase (Figure 3). Mobile wallet subscription has also been relaxed by the SBP, where, instead of bio-metric verification at the agent site, in-app biometric verification has been allowed. This is likely to have a positive impact on new account registrations⁶. However, as agents remain closed due to lock down throughout the country, cash-in and cash-out challenges persist.

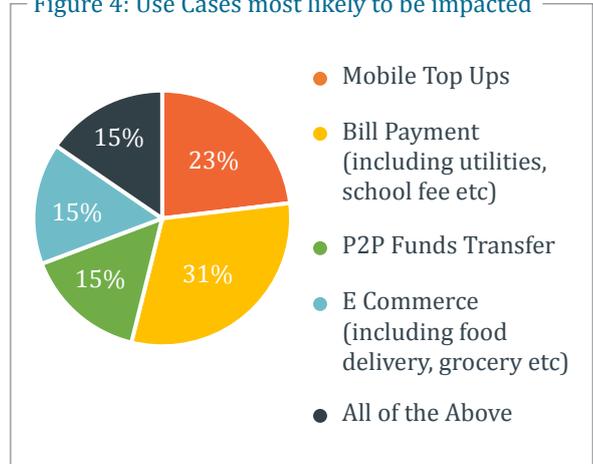


⁵ <https://propakistani.pk/2020/03/28/govt-relaxes-the-minimum-requirements-of-ehsaas-emergency-cash-program/>,
⁶ <http://www.sbp.org.pk/bprd/2020/CL10.htm>

As cash is being discouraged to control transmission of virus, there will be a significant push towards wider adoption of DFS. To avoid cash, consumers will increasingly adopt digital wallets and opt for contactless payments methods that will require less physical interaction. Similarly, social distancing advisory will also necessitate digital payments. However, despite the fact that the factors above may result in increased demand, it may be off-set by the slow-down in business activity across the country.

Mobile top-up accounts for ~45% of the overall transactions, whereas Bill payments have a ~4% share. However, our research shows that under the current circumstances, 31 percent of the DFSPs believe that Bill payment (school fee, utilities) will become the most popular use case in the coming months whereas Mobile Top Ups have been identified as the second most utilized use case (23 percent). P2P Funds transfer and E Commerce (including food deliveries and groceries) will also see a surge in utilization, as identified by 15 percent of the respondents, respectively. Similarly, 15 percent of DFSPs believe that all the four use cases will see a rise in utilization (Figure 4).

Figure 4: Use Cases most likely to be impacted



The shift in the type of transactions can be explained by the closure of a large number of DFS agents throughout the country, reduced banking hours and limited mobility of consumers. It can also be attributed to COVID induced change in customer behaviour i.e. avoiding large crowds and waiting lines, connecting to friends and family over the phone and internet etc. Similarly, there will likely be a shift to online shopping, as more consumers will shop online for the first time in new categories, particularly groceries and household essentials. Additionally, while the current estimate of active mobile accounts is around 24.5 million accounts, it is anticipated that many mobile wallet users will be transacting on behalf of friends and family for bill payments, mobile top up, and donations.

Another key use case would be donations, targeting daily wagers, who make up around 20 million individuals (30.1 percent of the labour force), out of which around 10-12 million will be out of work due the current scenario⁸. This can be through individual philanthropic efforts or pooled funds (similar to the Prime Minister’s COVID-19 Pandemic Relief Fund). The Securities and Exchange Commission of Pakistan (SECP) has also recently announced a regulatory sandbox, which invites applications on Crowdfunding for Donations. If successful ideas emerge from this sandbox and relevant platforms are established, this will act as an additional impetus to donations being transferred digitally.

Priorities for DFSPs

Responding to the likelihood of enhanced utilization of DFS, DFSPs believe that developing new innovative products (such as insurance) and introducing new use cases for consumers will help in accommodating the increased demand. Similarly, undertaking awareness campaigns, to educate on DFS usage, and creating trust for utilizing DFS will be imperative moving forward, especially in parallel to the objective of increased mobile wallet uptake.

Amongst the challenges that DFSPs will need to overcome include the unavailability of DFS agents, as a result of lockdowns in most areas throughout the country. This is likely to affect the distribution channel and a subsequent decrease in the OTC transactions. At the same time, however, this, creates a significant opportunity for alternate delivery channels (ADC) that serve customers outside of physical branches and shops. Introduction of cash-in at doorstep services could be one of the many examples of an ADC. In addition, curbing fraud, particularly resulting from the G2P disbursements will be a key priority for DFSPs in the coming months.

<p>Innovative new products (insurance etc) and develop more use cases</p>	<p>Undertaking mass awareness campaigns around benefits and utility of DFS, especially wallets</p>	<p>Improve agent liquidity</p>	<p>Curb fraud</p>
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⁸ Estimated provided by PIDE <https://www.pide.org.pk/pdf/PIDE-COVID19-EBook.pdf>

DFSPs also believe that introducing and utilizing new technologies in the payments ecosystem will be key to overcome challenges resulting from the partial lockdown, social distancing and less use of cash. As a result, DFSPs, especially Fintechs, may find themselves at the forefront of providing innovative solutions. While previously, the conventional financial sector players have somewhat resisted adoption of new technologies, Fintechs strongly believe that the current circumstances provide an opportunity for larger financial institutions to adopt new and innovative solutions.

Other Opportunities for DFSPs include:

- a. Develop digital lending solutions; including credit scoring models to assess credit worthiness of businesses and consumers alike to provide fast and sufficient liquidity
- b. Develop digital KYC solutions; with increased dependency on digital banking platforms, financial institutions will require digital and secure KYC solutions.
- c. Develop crowdfunding platforms; these can be especially helpful in supporting small businesses
- d. Creating B2B and B2P Payment platforms
- e. Developing In – app biometric solutions

Priorities for DFS Sector Enablers

Sector Enablers will also need to play a role in providing impetus to the DFS ecosystem in Pakistan in light of the current circumstances. These can be segregated into short-term measures to support consumers and agents, and long-term measures that will demonstrate the effectiveness of DFS and enhance usage.

Short Term Interventions

Push for utilization of Roaming Agents by DFSPs

Provide tax incentives on agent transactions for improved agent liquidity & business continuity

Maximize G2P cash transfers in Wallets (24.5 m active accounts out of total 46 m accounts)

BB agent services should be declared essential services

Our findings suggest that, in the short-term, sector enablers can take measures that will support DFS ecosystem, and facilitate consumers and agents. These include:

- Utilizing roaming agents- especially for cash transfers to the elderly, and people with special needs⁹.
- Provision of Tax Incentives on Agent Transactions - agents are primarily microbusinesses, allowing tax rebates on agent transactions will enhance liquidity and business continuity.
- Maximize G2P Transfers through Mobile Wallets - 46 million mobile accounts currently exist in the country, G2P payments of eligible beneficiaries can be disbursed directly into these accounts (depending on the number of eligible beneficiaries having an account)
- Include DFS agents in the 'essential' services list - DFS agents also fall within the ambit of financial services and are key to provision of necessary payments and cash to individuals, the government may consider categorizing them as essential services moving forward.

Long Term Interventions

DFSPs believe that, coming out of the current circumstances, the regulator can play a central role in creating a more sustained impact of DFS in the country in the long run. This can be done through:

- Provide incentives for retailers to accept digital payments (by reducing tax)

⁹ <https://karandaaz.com.pk/wp-content/uploads/2020/04/Roaming-Agents-Policy-Brief-1.pdf>

- Study consumer use patterns and behaviours resulting from social distancing, and capacity of DFSPs, to accelerate activity on achieving the NFIS goals
- Enhance daily cash out limits for agents, especially in rural areas
- Enable a one-window access for all DFSPs so that consumers do not have to download multiple applications to undertake transactions
- Create a central compliant management cell that can receive and track complaints against agents
- Facilitate low cost of payments
- Create a more efficient and sustainable DFS strategy to respond to crises situations moving forward.

Key Themes for Dialogue

While there may be conflicting views on how the DFS industry might be impacted in the long term, the industry can capitalize on opportunities, coming out of the current crisis. Our research shows that DFSPs and regulators need to come together for stronger collaboration, research and surfacing innovative ideas that can lead to a permanent change in behavior of users and ensure wider adoption. Moving forward, key themes which require dialogue are:

- a. Does the short-term increase in DFS transactions have a longer-term implication on user behaviours? Will this be a pivot towards increased dependency on DFS after lock down measures end?
- b. How are sector enablers and DFSPs collaborating in other countries during the crisis and what can Pakistan learn? Should there be more articulate emergency response strategies and wider collaboration between Government institutions, DFSPs, donors and other private sector stakeholders in place?
- c. What role can Start up-Fintechs play in the short and long term and does the role of these Fintechs warrant increasing collaboration with financial institutions?
- d. How will the current situation guide the DFSPs into devising strategies for the future? What gaps have been identified in the ecosystem due to the sudden emergence of demand for DFS and what measures will be needed to address those gaps, especially but not limited to the ones identified below:
 - ii. Robust Digital Payments Infrastructure
 - iii. Merchants on-boarding
 - iv. Developing more P2X models
 - v. Expanding product portfolio
- f. Does the current situation warrant a concerted effort by both sector enablers and DFSPs towards promoting in-app biometric solutions and digital KYC solutions (for on-boarding agents)?

About Karandaaz

KARANDAAZ PAKISTAN is a Section 42 company established in August 2014 and focuses on fostering economic growth and creating jobs through financial inclusion of unbanked individuals and unserved enterprises, with a special focus on women and youth. The company has four verticals:

Karandaaz Capital

Provides wholesale structured credit and equity-linked direct capital investments to micro, small and mid-size enterprises (MSMEs) that demonstrate compelling prospects for sustainable business growth and employment generation in Pakistan.



Knowledge Management and Communications

Supports the company's core financial inclusion goal by developing and disseminating evidence based insights and solutions.



Karandaaz Digital

Focuses on expanding the poor's access to digital financial services in Pakistan by working across the ecosystem with all stakeholders.

Karandaaz Innovation

Manages the Innovation Challenge Fund and Women Entrepreneurship Challenge, providing risk capital and grants to partners with the aim to generate innovative solutions in areas of financial inclusion and entrepreneurship.



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