Realizing the promise of responsible digital payments for merchants in Pakistan

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There has never been a better time for Pakistan to accelerate financial equality and digital financial inclusion for small merchants. Recognizing the economic challenges facing the country today, this opportunity is simultaneously essential, massive and attainable. The recommendations in this report show how to make it happen.

We applaud the State Bank of Pakistan for its strong leadership in Pakistan’s journey towards equitable digital and financial inclusion for all members of society, especially women. The launch of RAAST holds the potential to be a watershed moment after many years in the making. It is imperative that the promised benefits of faster payments are delivered to all segments of the economy, especially the traditionally underserviced, MSMEs and those led by women.

The benefits of responsible digital payments for MSMEs are tremendous and include improving cash flow and reducing costs, gaining new customers, transacting remotely, and access to credit. Digital payments can be truly transformative and a key tool to help entrepreneurs overcome systemic challenges. Across Asia, we have witnessed how the use of responsible digital payments by small and micro merchants has been a key to unlocking remarkable growth for MSMEs and, in turn, their economies. This can be true for Pakistan too.

Success will depend on creative partnerships. It will require a commitment to collaboration amongst the many public and private sector stakeholders to bring the promise of digital commerce to the 5 million small and micro businesses in Pakistan. These small and micro businesses contribute over 40 percent of the GDP, despite many challenges – imagine the future when they are able to thrive!

The Alliance Secretariat is committed to working with the Government of Pakistan on this exciting journey to responsible digital payments and financial inclusion across the country, so that small and micro businesses, especially those led by women, can indeed flourish.

Dr. Ruth Goodwin-Groen
Managing Director
Better Than Cash Alliance
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Businesses everywhere must embrace digitization or risk their future. The positive impact of digitization on economic growth is proven. Digitizing responsibly boosts financial inclusion, allows equitable participation in the economy, accelerates attainment of the Sustainable Development Goals and future-proofs enterprise.\(^1\) National adoption of digital payments in Pakistan by 2025 can boost gross domestic product (GDP) by 7 percent, generate 4 million jobs and realize an additional US$263 billion in deposits.\(^2\)

Micro, small and medium enterprises (MSMEs) represent over 90 percent of businesses in the country,\(^3\) but remain hamstrung by their dependence on cash. Bringing this sector into the digital age offers an enormous opportunity. Expanding digital offerings to women customers, for example, represents a market opportunity of more than US$650 million, or PKR 101 billion.\(^4\)

MSMEs in Pakistan are ubiquitous but undocumented. Informal businesses – nearly all MSMEs – account for 40 percent of the GDP\(^5\) and 78 percent of non-agricultural employment. However, the needs of MSMEs and their ways of working are poorly understood. As a direct consequence, this sector retains huge growth potential.

Half of Pakistan’s population is female, yet women-led MSMEs are marginalized, unrepresented in policy forums, and hindered by societal norms that make it harder for them to travel or conduct business.\(^4\) They are excluded from decision-making – as are the voices of all MSMEs. Exclusion means the needs of their enterprises go unheard. It is difficult to maximize the potential of an economy when half of the population is structurally impeded.

This landscaping report estimates that only a fifth of the population accesses formal banking systems. Adult literacy, at 58 percent, is lower than in peer nations. MSMEs are not catered for by the financial sector or by policy makers. Exorbitant interest rates, topping 30 percent, cripple the few financial products offered to MSMEs. Cash usage remains stubbornly high.\(^7\) Political instability undermines well-intended efforts to modernize the payments ecosystem and erodes trust in business owners. Consequently, there is no great demand among MSMEs for the digital dividend. Too often, despite specific accommodations, MSMEs falsely equate formalization and digitization with exposure to taxation.
Every national digitization journey is unique. The obstacles present in Pakistan today have been experienced by other countries. None of the challenges are new, which means they can be overcome. **Pakistan enjoys unique advantages.** The Small and Medium Enterprises Development Authority (SMEDA) is well-established, and further empowerment will enable it to drive transformative policymaking. The National Financial Literacy Program (NFLIS) is well-conceived and demands full implementation. Likewise, the Data Protection Bill has the potential to make strides towards securing user trust in digital payments.

A national digital agenda, sound policymaking, and a drive towards financial inclusivity can unleash the potential of Pakistan’s economy by ensuring that all of the population, including women, have the opportunity to engage in it. Above all, execution of this agenda must be driven by all stakeholders through a collective effort that is focused on driving meaningful results.

Merchant digitization and its enablement is a shared responsibility, that benefits all – the public sector, and all types of private sector participants. However, neither private sector actors nor state actors, such as the State Bank of Pakistan, can achieve merchant digitization alone. The scale of the challenge demands meaningful collaboration and alignment amongst all stakeholders to address the most complex challenges, such as merchant education and awareness.

The State Bank of Pakistan’s instant payments system, **RAAST**, will prove vital in driving widespread adoptions of digital financial services (DFS). It requires scalable use cases to generate awareness, trust and momentum.

Yet even here – with sufficient political will – there are easy wins to be had. By digitizing government-to-person (G2P) and person-to-government (P2G) payments, the Government of Pakistan can boost digital inclusion and augment demand and supply for digital liquidity, while previously unbanked MSMEs will be given the opportunity to thrive in a modernized economy.

**Pakistan possesses all the ingredients to make a success of digitization.** The country’s infrastructure and policies mean that it is well placed to make significant progress. However, success demands more than a promising combination of ingredients. It requires, among other things, a unifying vision, women-centric policies and coordinated action by multiple stakeholders that is shaped by the lived realities of the millions of micro and small merchants.

To ensure that the actions are informed and effective, stakeholders must make a concerted effort to ensure that the voices of small merchants, especially women, are heard. Their needs must be better understood, codified in policy, and translated into product design and delivery. The industry, and indeed the policy makers, must speak to them in their language and context.
Pakistan’s digitization journey will continue to render many valuable lessons for markets that share similar ground realities. Whilst these challenges will continue to evolve, this report addresses the near-term requirement of identifying challenges and solutions, and the ownership of tailored action points.

At a glance: Prioritized recommendations

The following is a summary of key recommendations, developed and prioritized through consultations with key industry stakeholders in individual sessions and a workshop hosted by the Better Than Cash Alliance in January 2023.

Recommendations are prioritized according to ease of implementation and likely short-to-medium term impact. Key recommendations are indicated by a ★.

Green ★: This recommendation is a higher priority: it attracts strong consensus, implementation is not complex, and it will likely result in significant measurable impact within the short term.

Amber ●: This recommendation is an intermediate priority: it has received general agreement, implementation is reasonably achievable, and it is likely to have measurable impact within the short to medium term.

Red ●: This recommendation is a lower priority: it is likely to be contentious, difficult to implement, and has a low immediacy of impact.

“Banks are not women-friendly spaces. If I can’t have agency over my finance or privacy, why would I want a bank account? Banks use email as a mode of communication and many women don’t have email IDs - understanding the user and the distribution strategy is important. The unreliability of infrastructure also adds to the problem of trust.”

Halima Iqbal, CEO, Oraan, Pakistan
# Executive Summary

## 1. Engagement, inclusion and representation

MSMEs are the largest but least documented segment of the economy. They are poorly understood, poorly represented and poorly engaged with the concept of digitization.

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<thead>
<tr>
<th>Organization</th>
<th>Recommendation</th>
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<tbody>
<tr>
<td>Small and Medium Enterprise Delivery Authority</td>
<td>★ ● Redefine the term ‘MSME’ to explicitly classify micro, small and women-led businesses as distinct from medium-sized businesses, to better cater to their unique needs and realities.</td>
</tr>
<tr>
<td>Securities and Exchange Commission of Pakistan</td>
<td>● Simplify business registration for sole proprietorships and small businesses whilst tying registration as a pre-requisite to access of government services and support programs.</td>
</tr>
<tr>
<td>Ministry of Industries and Production</td>
<td>● Accelerate SMEDA’s representation of MSMEs to inform policies that facilitate their growth.</td>
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## 2. Building trust in responsible digital payments following the United Nations Principles for Responsible Digital Payments

For digital payments to surpass cash, they must earn the trust of MSME owners. Transparency, reliability, accountability, and efficiency should be embedded throughout the digital value chain.

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<th>Organization</th>
<th>Recommendation</th>
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<tr>
<td>State Bank of Pakistan</td>
<td>★ Mandate clear disclosure of fees, charges, interest rates, and repayment terms, for digital financial services (DFS) providers to protect users from misleading information.</td>
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<td></td>
<td>● Solve for trust through standardized and mandated recourse mechanisms that drive confidence and growth in usage of digital payments.</td>
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<td></td>
<td>● Drive awareness amongst MSME owners of the costs of carrying cash and advocate the benefits of using digital payments.</td>
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<td></td>
<td>● Deliver the National Financial Literacy Program (NFLP) to build capacity and capability of small merchants.</td>
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<td></td>
<td>★ ● Enable tiered ‘know your business’ (KYB) regulations to facilitate adoption of formal financial services by micro and small businesses.</td>
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3. Financially include more women merchants

In Pakistan, cultural concerns impede how effectively women can access financial services.

### Ministry of Information Technology and Telecommunication
- Codify the Personal Data Protection Bill to build trust and formalize missing privacy and data protection for consumers.

### Securities and Exchange Commission of Pakistan
- Mandate disclosure of Annual Percentage Rate (APR) and repayment terms related to digital lending products to protect users from misinformation.

### Digital Financial Service Providers
- Build capability among first-time users covering fees, transaction limits, terms and conditions, and penalties in case of breach of contract.

- Build localized, assistive user experiences for low-capability, low-maturity first time users that are welcoming, safe, and disarming.

- Innovate methods to offer credit or working capital to informal segments through alternative scoring and collateral mechanics.

### State Bank of Pakistan
- Deliver the Banking on Equality strategy to design products for women-led SMEs and include women in the front-line delivery of financial services.

- Collect and publish gender disaggregated data for service providers to gain actionable insights on women-owned businesses.

### Digital Financial Service Providers
- Build an industry-level pipeline of female talent for DFS providers, with a strong focus on rural markets.
4. Accelerate adoption of digitization of payments through scaled use-cases

There is limited demand and supply for digital liquidity, hence limited adoption of digital payments by merchants who continue to transact largely in cash or cash-equivalents.

- **Federal and Provincial Governments**
  - ★☆ Shift all G2P and P2G transactions to digital platforms, starting with taxes, duties, and welfare payments, to augment both digital liquidity and demand within the economy.

- **State Bank of Pakistan**
  - ★☆ Digitize private sector wages, bringing the unbanked labor force into the formal financial system. Tie business access to government support and subsidies to paying employee wages digitally.

5. Financial viability of digital payments

Merchants operate on thin margins and high cost of transactions is restricting the adoption of digital payments.

- **State Bank of Pakistan**
  - ★☆ Drive a tiered approach to MDR based on size, segment, and business sector to protect margins and ensure the economic viability of MSMEs.
  - ★☆ Enhance competitiveness of digital payments by solving for instant settlement and utility of digital liquidity.
  - ★☆ Showcase the incremental value of digital payments, and unlocked growth opportunities, via scaled merchant education initiatives.

- **Digital Financial Service Providers**
  - ★☆ Through an industry initiative, build merchant and consumer awareness of the benefits and costs of the various payment options, including domestic schemes such as RAAST.
6. **Disarm the spectre of taxation**

Prospective users equate adoption of digital payments services with being formally taxed.

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<tr>
<th>State Bank and Federal Board Revenue</th>
<th>★ ● Harmonize policies and formalize a cross-governmental financial inclusion strategy for small businesses.</th>
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<tr>
<td>Federal Board Revenue</td>
<td>★ ● Lower sales tax rate for consumers on payments made through digital channels.</td>
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<tr>
<td></td>
<td>● De-link the adoption of digital payments, with contentious issues of formalization and taxation of MSMEs.</td>
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<tr>
<td></td>
<td>● <strong>Conduct market education</strong> on the tax-related incentives for digital payment adoption by small businesses.</td>
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“There are so many opportunities for improvement in Pakistan, but to do so, the public and private sector must work together to solve the challenges. We are already plotting our own journey to digitize the Pakistani landscape through RAAST and other innovative solutions that provide the necessary rails to all entities enabling them to offer efficient payment solutions to the masses. To take our country forward in the rapidly changing times, all stakeholders will be required to work collectively and collaborate with each other.”

Muhammad Imaduddin, Joint Director, Digital Financial Services Group, State Bank of Pakistan

“Making the financial world more inclusive to women has to go beyond aesthetics and get to the foundation of the problems. We don’t need more pink products, we need more women-centric policies. With such policies, we will be better equipped to become drivers of economic progress.”

Sukaina Abbas, CEO, Enxhanté, Pakistan
Micro, small and medium enterprises (MSMEs) are the backbone of domestic economies, driving innovation, employment, and growth.

An estimated 5.2 million MSMEs are present today in Pakistan. These businesses employ an estimated 78 percent of the non-agricultural labor force, contribute 40 percent of the GDP, and account for a quarter of national exports. The fortunes of the MSME sector and the fortunes of the national economy are intrinsically linked.

Compared with peer countries, Pakistan’s MSME sector is lagging in taking advantage of the benefits of digitization. It is vital that digitization of MSMEs in Pakistan is recognized and prioritized as an essential driver of economic advancement.

Anything less than a holistic, root-and-branch overhaul of the MSME ecosystem serves as an impairment of MSME’s ability to compete in an increasingly digitized world. The status quo in Pakistan traps these businesses in the lower reaches of the value chain, serving hyper-local needs and effectively excluded from the promise of the new interconnected global opportunity.

Digital payments are a proven pathway towards a modern, digital economy. Digitization empowers growth by enabling easy and equitable access to formal financial services. It also improves workflows, reduces costs, and mitigates against mobility constraints. This last is especially pertinent to women entrepreneurs who experience significant barriers in leaving their dwellings to participate in the formal economy.

As merchants become more familiar with digital platforms, growth opportunities are unlocked, enabling them to market online and enlarge their customer base. Crucially, the data collected through customer interactions generates insights on preferences and behaviors, enabling merchants to better tailor their products and services.

Whilst trading digitally, merchants accrue viable credit histories, allowing them to manage their finances better, formalize assets, and increase profits. And as MSMEs nationally digitize and profits increase, government tax receipts will increase in lockstep. Similarly, financial institutions expand their customer base by leveraging existing national datasets and these new digital signals to provide approximate credit worthiness to help accelerate the arrival of a thriving digital economy.

These benefits can only be realized if merchants adopt digital payments. Widespread adoption of digital payments requires trust. A responsible digital payments system is the key to building merchants’ trust and confidence in the ecosystem. And, as custody of users’ funds rests with the service providers, they must be transparently responsible and accountable.
Responsibility - Why it matters

The digital economy is now accelerating our attainment of the Sustainable Development Goals, guided by the United Nations Secretary-General’s Roadmap for Digital Cooperation. Governments increasingly rely upon it for government-to-person payments (G2P) – especially to the underserved and vulnerable.

The fintech industry is innovating at speed. Artificial intelligence (AI), machine learning, and big data platforms are remaking the industry at a terrific pace. These innovations bring change and risk. Worldwide, more than 80 governments have launched digital transfer programs. Those benefiting from a prior investment in digitization outperform the rest.

Growth is incredible, yet challenges remain. Most underserved users either distrust (or are unfamiliar with) digital payments. Women are disproportionately excluded, even when their participation remains the single most important catalyst to financial equity.

The United Nations Principles for Responsible Digital Payments, developed by the Better Than Cash Alliance and guided by its member governments, companies, and international organizations, advocate for who needs to be responsible, what it means to be responsible, and how to be responsible when considering digital payments, and by extension, digitization of businesses.

Considered adoption of the nine principles solves for the long-term success of digital transformation initiatives by thoughtfully building trust, mitigating risks, and driving inclusivity in the desired outcomes.

Within the context of merchant digitization in Pakistan, implementing responsibility into the policies, service design, and go-to-market strategies, improves the probability of success – delivering outcomes that are sustainable, persistent, and universally accessible, whilst solving for the lived challenges of small merchants and their unique context.

This report highlights five of the nine principles. These five are key factors of success of digital payments by MSME businesses and entrepreneurs in Pakistan, which all stakeholders must come together to deliver.
**Principle 1. TREATING USERS FAIRLY**

Companies, distributors, and supply chain players all have an important role in bringing trusted commercial relationships, and a clear understanding of business requirements, to help MSME entrepreneurs develop resilient digital skills and capacities in order to succeed. The imperative is to do so in an equitable fashion, that ensures that all users – women, rural, urban, and other served segments – have equal opportunity to access and reap the benefit of digital inclusion, despite differing circumstances.

**Principle 3. PRIORITIZE WOMEN**

When moving from cash to digital payments, women are often negatively affected by limited access to a smartphone or dedicated featured phone, by poor access to ID, and by a limited ability to go to bank branches or agents. Building with gender intentionality means taking steps to ensure an understanding of such market constraints facing women, and by recognizing that women have different needs at various stages in their life cycles that can be addressed by different financial and non-financial services.

Women in Pakistan also often experience challenges in access to and use of digital financial services, including challenges with basic financial and digital literacy. Developing and tracking specific metrics on women’s adoption of digital payments and their engagement with the digital solutions will help to proactively identify solutions at the points where women may be experiencing challenges.

**Principle 4. DESIGN FOR INDIVIDUALS**

Scaled adoption of digital payments in Pakistan can be supported quickly by focusing on businesses that possess some form of digital readiness. These segments have existing bank accounts, access to functional debit cards, experience using digital payments, and good access to phones and connectivity. Yet less digitally ready businesses must not be ignored or deprioritized, or the digital divide may widen. To prevent this, stakeholders – private and public – must collaborate to develop tailored strategies to give access to smartphones, accounts, and/or debit cards.
Principle 6. BE TRANSPARENT, PARTICULARLY ON PRICING

The surging growth of digital payments services means that providers are increasingly engaging with new users. These customers often find the software and terminology surrounding digital finance opaque and bewildering, but they are not alone. A disinclination to read the small print persists in more knowledgeable consumers, and lack of understanding breeds distrust. To build a thriving and inclusive payments ecosystem, the trust deficit must be bridged. Equipping users with the information needed for a positive digital payments experience builds a more predictable environment. Predictability fosters the requisite trust. This requires strong intent and action, from all stakeholders, to ensure that trial of digital payments leads to quick and persistent adoption.

Principle 8. MAKE RECURCE CLEAR, QUICK AND RESPONSIVE

Grievance redressal procedures have not kept pace with the increasing sophistication of payment platforms. Recourse, then, requires an overhaul. When faced with a problem, users require not only a fix but also a holistic understanding of the whole redressal process. Commonly, users have become cynical, wary, and feel that the onus of resolution rests on them. It should be borne in mind that, for the underserved, recourse systems act as a lifeline. Loss of funds is proportionately more important to low-income users who consequently operate from a baseline of abundant caution. A successful recourse system is therefore one that is accessible, shares clear information with the user, and delivers resolutions that are timely and accountable.

Learn more about the Responsible Digital Payments Principles at www.responsiblepayments.org
2.1 Market size and economic outlook

Pakistan is a densely populated country of 227 million people growing at roughly 2 percent per annum. Fifty-three percent of the population are adults aged 15–59 years and 49 percent of the population are women.

A fifth of the population is formally banked, compared to an average of a third for lower middle-income countries. Despite a growing population and the business opportunity conferred by a digital dividend, digital financial services (DFS) have yet to gain significant traction in Pakistan.

The reasons why these demographic opportunities remain untapped are manifold. On the demand side, one key barrier is literacy. The literacy rate for 15-year-olds and above languishes at 58 percent for males and 46 percent for females. Comparative rates for Bangladesh and India are roughly 75 percent.

On the supply side, a further complication is presented by the size and nature of the informal economy. The informal sector contributes 56 percent of Pakistan’s GDP. Yet, due to their nature, the Government does not enjoy clear oversight of these businesses, making serving them with any degree of efficacy extremely challenging.

Alongside a growing population, Pakistan registered a GDP growth of 5.97 percent in 2022. This is considered unsustainable due to national macroeconomic imbalances exacerbated by political uncertainty and the aftereffects of the pandemic. Additionally, private sector consumption contributed 86 percent to GDP in 2022 – disproportionately higher than regional peers – and the fiscal and current account deficits continue to widen. Countermeasures by the Government in the form of increased taxation alongside fiscal tightening will curb consumption and investment in the economy, thus dimming near-term growth prospects.

2.2 The financial inclusivity of MSMEs

Financial inclusion in MSMEs can be measured though businesses’ ability to access finance that unlocks the ability to take advantage of growth opportunities. A majority of MSMEs in Pakistan rely on retained profits and earnings, informal financial services, or (less frequently) self-financing. This makes them highly susceptible to externalities, including those as minor as a family illness. As a result, the restricted availability of capital impacts how and when such businesses can expand. Formal financing via digital transaction is anathema to most businesses.
The difficulties do not end there. On the rare occasion when financial institutions are willing to offer finance, they often charge upwards of 30 percent in interest and service charges, rendering them unaffordable. As a result, informal lending is overwhelmingly prevalent.

Similarly, promoting equitable opportunities for women-led MSMEs (Principle 3 of the Principles for Responsible Digital Payments: Prioritizing women) to access finance is critical for sustainable and inclusive economic growth in any country. Improved gender parity in financial and economic opportunities enhances wider development outcomes now and in the future. Better opportunities for women to earn and control income are proven to contribute to broader economic development through higher levels of school enrollment for girls, improved productivity of female-owned companies, and raised potential for economic growth. Economies reap a compound benefit as women are more likely than men to use their earnings and increased bargaining power to buy goods and services that improve the family’s welfare.

Pakistani women, who represent 49 percent of the population, still lag men in financial inclusion and economic activity metrics. Greater access to formal finance drives economic empowerment and allows more women to participate in the economy. The incremental opportunity is sizeable: “for Pakistan’s payment service providers (PSPs), expanding offerings to women customers means a market opportunity of more than US$650 million” or PKR 101 billion.

Table 1. State of small and medium enterprise (SME) financing and financing targets

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<th></th>
<th>As at December 2021</th>
<th>Targets set in the NFIS and SME Policy</th>
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<tr>
<td>SME Financing</td>
<td>PKR 460 billion</td>
<td>PKR 800 billion</td>
</tr>
<tr>
<td>SME Financing as proportion of total private sector financing</td>
<td>5.4%</td>
<td>17%</td>
</tr>
<tr>
<td>SME Borrowers</td>
<td>160,736</td>
<td>700,000</td>
</tr>
<tr>
<td>SME Borrowers as proportion of total SMEs</td>
<td>3%</td>
<td>13%</td>
</tr>
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“Another largely excluded segment is SMEs: banks are currently serving the financing needs of only 3 out of 100 SMEs.”

Dr Reza Baqir - Former Governor, State Bank of Pakistan
Reaching financial equality for women in Pakistan

Despite making up 49 percent of the total population, Pakistani women have a remarkably low participation rate of only 21 percent in the current workforce. With male income-earners responsible for most middle-class households, the annual income per capita has declined in Pakistan over the past decade.

Reversing this trend calls for a boost to the active participation of women across all economic sectors, especially in entrepreneurship and business ownership. Pakistan lags its peers with the lowest number of MSMEs per capita in the world, of which only 8 percent are owned by women.

Empowering and including women in the economy could be the untapped opportunity to drive growth and development that is essential for reviving a faltering economy that has been impacted by natural disasters and the COVID-19 pandemic. If the labor participation rate of women in Pakistan were to achieve parity with that of men, it could unlock growth equivalent to an incremental 60 percent increase in GDP as early as 2025, equivalent to PKR 12 trillion (US$54 billion).

However, to improve the path of women to the workforce in Pakistan, their readiness must be addressed – a large component of which is financial inclusion. In the past decade, Pakistani women’s economic and financial inclusion has become an increasing priority for governments and companies, driven by evidence that its benefits range from increased agricultural output to greater business resilience, customer retention, and GDP growth. Despite this evidence, the unfortunate truth about the challenges of providing digital financial services to women is well documented.

In Pakistan, too many women lack access to formal identification, and so are unable to open a bank account, own property, or develop a credit history, which are essential to save, build assets, secure a loan, and open or expand a business. Many cannot even buy a basic mobile phone to send and receive money. Financial service providers of all kinds operate without women in leadership or equal numbers of women agents and bank tellers. Many financial service providers have not yet realized how women clients can be a strong profitable customer segment, and have not invested in products, services or channels that meet women’s needs.
The impact of COVID-19 on women and girls has been severe. The World Bank reports the first increase in extreme poverty since 1998, with a minimum of 71 million people globally expected to fall into destitution, and UN Women estimates that at least 47 million more women and girls will fall below the poverty line in 2021. In Pakistan, women remain more vulnerable to layoffs and loss of livelihoods.

Women are essential to the subcontracting system, especially for small enterprises operating from home-based or informal workshops. Of the 12 million home-based workers in Pakistan, 80 percent are estimated to be women. Many women employed by small or medium businesses and/or working as domestic workers have faced pay cuts or layoffs due to a slowdown in economic activity. Pakistan’s women-owned microenterprises have been 8 percent more likely to lose their entire revenue due to the ongoing pandemic.³²

The response to financial inequality has been well-intentioned but fragmented. The ambition post-COVID-19 needs to match the massive scale and urgency of the crisis. Success is dependent on everybody doing their part.

Drawing on decades of experience, research, and in-field activity, the following 10-point action plan to end financial inequality for women aims to help end the continued economic exclusion of half the world’s population and to build more resilient economies.

**10 Actions to reach financial equality**

01. Digitize private sector payments
02. Digitize payments of government social benefits
03. Outlaw discrimination against women
04. Ensure universal access to identification
05. End the gender gap in mobile phone ownership
06. Hire women at banks and mobile network operators
07. Collect, analyze and use sex-disaggregated data
08. Design appropriate and affordable financial products for women
09. Help women benefit from e-commerce opportunities
10. Create and enforce strong finance consumer protection mechanisms
2.3 Payment digitization

To scale up digital payments, there are certain prerequisites. Specifically, to use digital payment channels a merchant requires a verifiable identity, a phone, a SIM card, an account, and often point of sale (POS) hardware, alongside the necessary levels of financial and digital literacy. These requirements create both demand- and supply-side barriers to adoptions.

**Verifiable identity.** Verifiable digital identity is a foundational pillar of an economy that empowers users to reap the benefits of digital and obviate the need for physical proximity. Pakistan has made significant progress in developing its biometrically verifiable identity database and increasing registration rates (especially for women) by successfully linking identification and social protection. Pakistan’s national ID system covers 98 percent of the adult population.

“We incentivized women to register by making clear that if they were poor, they would be eligible to receive a subsistence grant from the Benazir Income Support Program (BISP) – a financial inclusion program geared towards the poorest of poor women. For a woman to register for BISP, they would need to register with NADRA for an ID card.”

Tariq Malik, former Chairman of NADRA

Under the aegis of the Benazir Income Support Program (BISP), some 6 million families have advanced towards financial inclusion via payment cards or mobiles backed by bank accounts. These services also proved to be a catalyst for branchless banking in Pakistan, which has since gained momentum.

**Phone and SIM card ownership.** The Pakistan Telecommunication Authority (PTA) reports a tele density of 88 percent, with 195 million cellular subscribers, and internet penetration of 55 percent. There are a total of 120 million 3G/4G subscriptions and 123 million broadband subscriptions in the country.

According to the Global System for Mobile communications Association (GSMA), Pakistan had 89 million unique cellular subscribers as of 2019. Fifty-four percent of the population has network coverage but are unsubscribed from mobile internet services. The report identifies access to connectivity and affordable devices as key drivers.
**Account ownership (Figure 1).** Roughly 130 million adults own a bank or wallet account, equating to an effective penetration rate of around 60 percent – one of the world’s lowest. While the number of women account holders has increased, the gender gap has also widened: for every three men who have a bank account, only one woman does. 

**Growth in internet and mobile phone banking transactions (Figure 2).** The value of internet and phone banking transactions reached PKR 10.2 billion and PKR 11.9 billion respectively in 2022. In the last four years, the corresponding transaction values have grown at a Compounded Annual Growth Rate (CAGR) of 69 percent (internet) and 132 percent (mobile).
The number of internet banking users doubled from 3.1 million in financial year (FY) 2018 to 8.4 million in FY 2022 (Figure 3). Similarly, the number of mobile phone banking users has quadrupled in the same period, as seen below. The volumetric shift towards these channels precipitated by the COVID-19 pandemic was further fueled by a removal of the Inter-Bank Fund Transfer (IBFT) charges by the State Bank of Pakistan (SBP) during the pandemic-related lockdown. The increasing number of mobile banking users correlates with increasing tele-density in Pakistan. As the number of mobile banking users increases, transaction values also rise, predominantly due to the increased frequency of high-value transactions by both individual and corporate users.

Figure 3. Number of internet and mobile phone banking users (millions)

Trends in card-based transactions (Figure 4). The volume of ATM transactions increased by 10 percent on an annualized basis between FY 2018 and FY 2022. Despite upward trends in the volumes of POS (21 percent) and e-commerce (91 percent), the overall proportion of digital transactions in both volume and value compared with ATMs remains much lower, denoting the widespread preference for cash.
Retail payments infrastructure. Currency in circulation has doubled in value to PKR 7.6 trillion in FY 2022 from PKR 4.6 trillion in FY 2018, denoting an increased demand for cash, representing roughly 29 percent of total currency being in circulation. It is typically less than 20 percent in developed economies where the economy is more digitized than in Pakistan. Due to the low frequency of digital payments at retail, more than 80 percent of the payment card transactions occurred at ATMs. Over 90 percent of these were subsequently used for cash withdrawal. The number of POS devices grew by 18 percent on an annualized basis. The number of e-commerce merchants grew by 45 percent. However, the numbers of payment cards issued (comprising ATM, debit, credit, pre-paid, and social welfare cards) have remained stagnant.

Table 2. Digital payment acceptance channels

<table>
<thead>
<tr>
<th></th>
<th>FY18</th>
<th>FY19</th>
<th>FY20</th>
<th>FY21</th>
<th>FY22</th>
<th>CAGR</th>
</tr>
</thead>
<tbody>
<tr>
<td>POS Devices</td>
<td>53,511</td>
<td>56,911</td>
<td>49,067</td>
<td>71,907</td>
<td>104,865</td>
<td>18%</td>
</tr>
<tr>
<td>Payment Cards</td>
<td>40,918,993</td>
<td>42,237,999</td>
<td>42,814,427</td>
<td>45,936,349</td>
<td>42,440,696</td>
<td>1%</td>
</tr>
<tr>
<td>e-Commerce Merchants</td>
<td>1,094</td>
<td>1,307</td>
<td>1,707</td>
<td>3,003</td>
<td>4,887</td>
<td>45%</td>
</tr>
</tbody>
</table>
The number of POS devices in use did not see any significant growth until the end of FY 2021, when over 43,000 devices were added to the payment system, bringing the total number of active POS devices to 92,153. While POS devices have increased in number, stakeholder interviews revealed an average of two or more devices per merchant. Consequently, an estimated 40,000 merchants use POS machinery. This implies DFS providers have not grown their user base beyond high value merchants.

“Our stores have usually two to three POS devices. The second one in case primary one isn’t working and the third is for points redemption or for trying a new service if we get a better deal. Ideally, we would want to work with one machine given the varying MDR rates.”

Asfandyar Farrukh, Chainstore Association of Pakistan

**Growth in branchless banking.** Branchless banking (BB) offers a convenient, affordable, and time-efficient alternative to bricks-and-mortar models. BB users are invited to avail themselves of a range of financial products and services via multiple channels. In Pakistan, BB is often used as an umbrella term, referring to delivery channels such as mobile wallets, agent-based banking, and comparable offerings.

BB has enjoyed healthy growth since 2018, with a doubling of the number of BB accounts, in part fueled by the pandemic and supportive measures by the SBP (including revised authorizations and extended timelines for biometric verification to minimize COVID-19 risk). Pakistan has witnessed growth in the adoption of BB payments (Figure 5), where mobile wallet transactions accounted for up to 93 percent of customer-oriented transactions by December 2021. Conversely, over-the-counter (OTC) transactions have flattened from 41 percent in June 2018 to 7 percent.
2.4 Regulatory environment

Policies and initiatives introduced in Pakistan over the last few years have set the foundation for a thriving digital payments ecosystem and strengthened the digital infrastructure. While political instability and economic uncertainties have hindered long-term implementation, the government’s drive to document and formalize the economy has had the unwelcome side effect of inducing skepticism of adoption among its target audience, MSMEs.

Successful policy interventions require engagement with all stakeholders. This is particularly true of interventions dealing with the base of the pyramid. In the absence of such engagement, Pakistan may not accelerate the adoption of digital payments as quickly as it wishes.

The timeline in Figure 6 illustrates the key policies and initiatives of recent years to supercharge the digital payments ecosystem and drive financial inclusion. A summary of key policy highlights is provided in Annexure C of this report.
Digital payment incentives

The Financial Inclusion Global Initiative (FIGI) was a collaborative program designed by the World Bank Group and the International Telecommunications Union to grow electronic payments and drive national financial inclusion targets.

The FIGI working group founding premise is that giving individuals access to transaction accounts by itself is insufficient. Universal access, therefore – whereby all adults worldwide have access to a transaction account to store money, send and receive payments – is not the endpoint. There is also the issue of whether a transacting account confers benefit to its users. This is broadly reflected in frequency of usage, including whether that usage is of other financial services. While effective usage of transaction accounts expects the following three functions: (i) satisfy the majority of payment needs; (ii) safely store value; and (iii) serve as a gateway to other financial services, in the final analysis, it is by incentivizing digital payments over cash that drives adoption.

In interviews for this report, multiple stakeholders argued the same point: *“If a cash payment is as good as a digital payment, then why would a merchant prefer digital?”*
Pakistan’s public and private sectors have made great efforts to incentivize merchants and consumers to adopt digital payment methods. However, political instability and the lack of continuity in the relevant authorities leads to inconsistent application of incentives that, in turn, breeds mistrust and confusion among end users. Consequently, the impact of these incentives is materially diffused. For example, in 2022 the FBR initially granted a PKR 150,000 tax credit on POS device installation that allowed businesses to invest in the required hardware and software. However, the incentive was abruptly withdrawn, leaving the market players bewildered. Similarly, in the wake of the COVID-19 pandemic, SBP waived service fees on all IBFTs in March 2020. As a result of this, 1 Link (the default national payment switch in Pakistan, providing interconnectivity between banks, wallets, etc.) witnessed a five-fold increase in transactions per day by December 2020. The waiver was rolled back in June 2021, limiting cost-free IBFTs to a maximum of PKR 25,000 per month per account.

“If the government authorities feel incentivizing digital transactions or reducing tax rates on digital channels makes them lose tax revenue, then at least make cash more expensive, i.e. if a merchant is dealing only in cash then their tax rate should be higher and that should give them some respite.”

Representative, Payment Service Providers
3.1 Engagement, inclusion, representation

Challenges

Successfully digitized businesses have willing and engaged owners. MSMEs in Pakistan typically lack engagement with the concept of digitization. They are also excluded from the policymaking process that governs its deployment. Formal representation is needed to allow MSMEs to inform and guide policies that reflect and respond to their lived needs. There are also gaps in the authorities’ understanding of the nuanced segmentation that occurs in the vast universe of micro and small enterprises.\(^5\)

SMEDA, which works to coordinate efforts across government departments, champions the adoption of a universal SME definition by all stakeholders in its SME Policy of 2021.\(^5\) Microenterprises, under this definition, are self-employed individuals or businesses with 10 or fewer employees working as carpenters, electricians, farmers, shepherds, mechanics, or similar.\(^5\) These are typically undocumented businesses that operate informally. However, small, micro, and women-led enterprises are not covered as distinct by this definition, rendering a large and nationally important MSME segment without formal representation and therefore recognition.

Policy action is required to recognize the disparate needs of diverse segments of micro and small merchants, especially those that are women-led, not only to provide them with access to financial services but also relevant solutions to realize the benefits of digitization.

Recommendations

1. Flexible and reflective policymaking. Micro and small enterprises in Pakistan are extremely diverse. Their fortunes are impacted by the sector of their operation, the gender of the business owner, their socioeconomic status, and the business’ growth stage.\(^5\) A more inclusive definition of MSMEs, which recognizes the material differences between micro, small and medium businesses – especially those that are women-led, their lived realities, and needs – is needed.

> WHO? GOV, MIN, REG
**Micro business is serious business**

Micro businesses represent the lowest organized economic unit, providing livelihoods, economic growth, and services to a large percentage of the world’s population with agility, efficiency, and resiliency that other businesses, many times their size, cannot.

Micro businesses must therefore be recognized and catered to as a distinct class of business with unique needs and circumstances: micro businesses tend to be resource-poor, have fragile unit economics, and tend to be clustered in highly fragmented industries, where price competition is common and margins are thin.

In most micro businesses, the owner’s take-home in a small business represents a much larger fraction of revenues, often to the extent that little is left over to invest in growth, employees, or services the business needs to grow (and formalize). Often operating from a single “wallet”, micro businesses are vulnerable.

Yet despite their challenging circumstances, micro businesses are a significant source of employment, economic productivity, and wealth creation globally. In emerging markets like Brazil, they account for 27 percent of GDP, and in Indonesia, 98 percent of all businesses are classified as micro or small. Micro businesses are found in industries as varied as agriculture, retail, manufacturing, and handicrafts.

Governments around the world, from New Zealand to Saudi Arabia, are increasingly recognizing the importance of micro businesses and are acting to strengthen this core component of their economies. India, New Zealand, and Zimbabwe have recently launched ministries focused exclusively on prioritizing and representing the MSME sector, with India launching initiatives such as Udyam Assist to ensure enumeration, recognition, and access to finance.

2. **Streamline registration and tier KYB/C requirements.** Similar to policies for end-consumers, ease the business registration process of MSMEs by adopting a tiered approach to KYB/C requirements.

> **WHO?** GOV, MIN, REG

3. **Link business registration with eligibility for, and access to, government services to encourage merchant formalization.** This reduces cost, minimizes onboarding frictions, and creates national databases allowing for a granular understanding of the business landscape and more effective decision making.

> **WHO?** GOV, MIN, REG

4. **Formalize representation.** Mandate a formal body to include representation from MSMEs with the requisite convening and legislative power to formulate policies to accelerate the growth of small businesses that respond to the economic and commercial realities of MSME owners.

> **WHO?** GOV, MIN, REG, PRISEC, DFSPs
3.2 Building trust in digital payments

Challenges

Trust is an essential prerequisite of digital payment adoption but is fleeting and must be continuously earned and reinforced. It must be acknowledged that the financial services industry has not delivered products and services in a way that has inspired trust amongst consumers and merchants alike. Industry and regulators must work together to build greater trust in digital payments, own the perception of digital payments beyond their individual silos, and address the issues of fraud, recourse, and reliability, as a shared responsibility. Bad actors, or poor performers within the value chain, can easily destroy the collective reputation of digital payments and prevent their wholesale adoption.

The fact that the share of cash in Pakistan’s economy continues to rise, and e-commerce transactions continue to be strongly cash-based, is testament to the size of the existing trust gap. The United Nations Principles for Responsible Digital Payments advocate for transparency, particularly on pricing, and strong recourse mechanisms, to bridge the trust deficit and build a thriving, inclusive payments ecosystem.

Lack of transparency

Research across Pakistan highlighted a lack of trust in digital payments as a major reason for a prospective user’s reluctance in transitioning to digital. Interviewees doubted how accurately transaction rates are adhered to by agents, citing arbitrary fees for similar transactions via their mobile wallet accounts. Although required to display transaction charges, agents operating from small mobile accessory shops and ‘kiriyana’ (corner) stores expressed that they had neither space nor time to do so.

65% of respondents stated that reliability was one of their top three reasons for preferring cash over digital payments.

“I am unaware of how much agents are required to charge per transaction’ said an artisanal woman specializing in embroidered work, explaining that knowing how much agents are required to charge per transaction would increase her likelihood of availing a digital payment service.”

ReSameena, Embroidery Worker, Multan
Data protection

There is an exponential increase in data generated by digital footprints. This encompasses information on call records, text messages, social media engagement, and websites visited. The increase in data raises a raft of data governance issues relating to access, usage, storage, and sharing.\(^5\)

Respondents cited fraud as a disincentive to adoption of digital payments. Many unregistered entities (particularly instant credit apps) are operating in Pakistan and charge exorbitantly high rates while beguiling customers with misleadingly attractive terms. Unregistered means unregulated. Digital payments inhabit an intersection of regulatory oversight, meaning complainants are unsure who to approach to resolve disputes.\(^5\)

Pakistan does not have any data protection legislation that specifically regulates the processing of personal data. The Prevention of Electronic Crimes Act, 2016 (PECA) is the only pertinent legislation that provides a legal framework in relation to unauthorized access to personal data. The Personal Data Protection Bill 2021 introduced by the Ministry of Information Technology and Telecommunication (MOITT) is yet to become law.

Ghana: Scaling digital payments through trust\(^5\)

In the past, Ghana’s financial institutions focused on corporate banking and high-net-worth individuals, effectively denying over 70 percent of adults access to financial services in the formal financial sector. However, the high patronage of mobile money has showcased the potential of retail financial services, increasing banks’ interest in financial inclusion across the country. Data from the Bank of Ghana shows that 18.8 million mobile accounts were active as of June 2022. Over 80 percent of bank transactions originated from electronic/digital channels. In January 2022 alone, the Mobile Money Interoperability system recorded GHC 2.107 billion (US$0.263 billion) in transactions, a 57 percent jump from the GHC 906 million registered in January 2021. These data points indicate a fast-growing maturity of Ghana’s financial technology sector and adoption of digital channels.

To enable this successful transformation, Ghana employed a three-pronged approach to developing trust within the financial system via a combination of technology infrastructure, legislation, and awareness creation.

Ghana has adopted several initiatives backed by legislation, including the recognition of digital assets as personal property, and the nationwide re-registration of SIM Cards with biometric identity. These initiatives brought about a single source of truth that effectively links the national identification card, supporting verification, and authentication of individuals’ details.

Trust in the system was further enhanced by the introduction of data protection legislation, to protect individuals’ privacy and personal data and to effectively combat and persecute cybercrime and payment frauds. The improvements in legislation and regulatory policies were accompanied by national awareness campaigns to raise awareness of both the newly introduced safety measures and penalties for fraud.
Recommendations

1. **Build trust and transparency.** Providers can educate first-time users on fee structures, transaction limits, terms and conditions, and penalties in case of contract breach to establish trust.

   > **WHO?** DFSPs, REG, GOV, BAN

2. **Mandatory disclosure.** Providers must provide up-front disclosure of fees, charges, and terms and conditions to deliver a reliable experience.

   > **WHO?** DFSPs, REG, GOV, BAN

3. **Establish accountability through service level agreements (SLAs).** Digital Financial Service Providers can use SLAs to formalize how the division and overlap of responsibility is allocated among providers embedding accountability in the value chain. This can also include gender-sensitive training and responsive issue escalation matrices to ensure customer representatives treat everybody with equal dignity and respect.

   > **WHO?** PRISEC, DFSPs, REG

4. **Enhance data protection.** MOITT can expedite the process to formalize the Personal Data Protection Bill, 2021, as a priority to earn consumer trust. Guidelines may be published around flow merchant data to ensure that services provide a transparent view of when, why and with whom data may be shared and contingent rights around data protection.

   > **WHO?** GOV, REG, BAN, MIN

### 3.3 Cash is perceived as more convenient

The low uptake of digital payments among merchants is largely because they perceive cash as being more convenient. Even in advanced payments markets, the use of cash has not declined as steeply as digital payments have grown. The table below from CGAP summarizes the perceived strengths of cash over digital channels that inform users’ preference.
Merchant interviews revealed similar assumptions. Cash was viewed as hassle-free, quick, final and trustworthy, particularly by micro and small merchants. Respondents complained of delayed settlement and long waiting times, inconsiderate or impolite representatives, and complicated, bureaucratic procedures that could be avoided entirely by using cash. Consequently, the demand for cash transcends that of digital as suppliers also insist upon cash payments from retail merchants.  

“Micro and small cost-sensitive merchants prefer cash over digital payments mainly because, unlike digital payments, there are no direct costs associated with carrying cash. Literacy programs are needed to educate them on the indirect costs of transacting in cash and potential cost savings the merchant can do through adopting digital payments, in addition to the convenience it will bring for their day-to-day operations.”

Representative, Payment Service Provider

Whereas, for larger enterprises, especially franchises in the retail and services segment, digital payment adoption was largely viewed to be customer-demand driven rather than merchant driven. Those merchants who felt digital payments to be a safer and more efficient method were, unsurprisingly, also more aware of the risks and hidden costs of cash.

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**Table 3. Perceptions of cash and digital for business payments**

<table>
<thead>
<tr>
<th>Cash</th>
<th>Digital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Free to use</td>
<td>At least one side pays the cost</td>
</tr>
<tr>
<td>Accepted everywhere</td>
<td>Accepted by select merchants</td>
</tr>
<tr>
<td>Used by everyone</td>
<td>Used by selected customers</td>
</tr>
<tr>
<td>Fast to exchange</td>
<td>Often slow to use</td>
</tr>
<tr>
<td>Intuitive to use</td>
<td>Often complex to use</td>
</tr>
<tr>
<td>Anonymous</td>
<td>Not anonymous</td>
</tr>
<tr>
<td>No prerequisites</td>
<td>Requires hardware/infrastructure</td>
</tr>
<tr>
<td>Reliable</td>
<td>Subject to network, power, and transaction failures</td>
</tr>
</tbody>
</table>
3. Challenges and recommendations

Recommendations

1. Explain alternatives to cash. Authorities can introduce policies to champion the speed, safety, and convenience of digital payments. Countries like Greece, Mexico, and Nigeria have witnessed a pronounced increase in installation of POS machines and issuance of debit cards after limiting the transaction ceilings for cash and championing digital services.60

> WHO? GOV, MIN, DFSPs, PRISEC

2. Collaborative outreach goes further. Merchant readiness and education is a shared responsibility with shared benefits. SBP can build trust by partnering with private organizations, wholesalers, and distributors to increase awareness amongst MSMES of product benefits. Expansion of the National Financial Literacy Program (NFLP) through coordination with private organizations will enable efficient engagement with large audiences.

> WHO? GOV, PRISEC, DFSPs, MIN

3.4 Infrastructure reliability

Processing digital payments requires reliable technology infrastructure. DFS providers incur heavy costs provisioning such enabling technology for merchants. Stakeholder interviews revealed that capital expenditure on this infrastructure equates to around 40 percent of gross margin. Similarly, the costs of owning a smartphone have also risen due to a devalued currency, rising taxation, and import duties.

Access to a reliable electricity grid, and its contingent effect upon network coverage, combine to hinder expansion of digital payments. Indeed, erratic mobile network coverage, poor transport links, regular power outages and disruptions in internet access are commonly cited impediments by DFS providers.

Telecom in Pakistan, to date, has made strides in expanding affordable connectivity and this drives financial inclusion via uptake of mobile wallets; “However, it seems to be reaching an inflection point that warrants serious attention from the policy makers and industry players”.61

Systemic capacity limits leave little room for DFS providers to provide digital payments that are reliable, sustainable, scalable and cater to stakeholder needs and requirements.

There is also significant inequality in physical access to banking. The bank branch network is concentrated in urban areas, with only 28 percent of branches located rurally,62 where over half the population lives. While it was expected that BB agents would resolve the issue of access, at the time of writing only 46 percent of the 534,460 registered BB agents are active.
“There seems to be lack of understanding on operating an agent network and its economics. Where branch network is heavily CAPEX based, operating an agent network is heavy on the OPEX. Since agents aid in conversion of physical cash to digital, there are costs associated with which need to be recovered by the service provider.”

Representative, Payment Service Provider

Recommendations

1. **Ensure systemic resilience.** Reliable network infrastructure is a prerequisite of successful delivery of digital services. Policy makers viewing telecom, banking, and payments services as a public utility will drive operator investment into infrastructure. SBP, at the earliest opportunity, should revisit recent cash margin restrictions and remove the pre-approvals policy on importing telecoms equipment to mitigate adverse impacts on short and medium term systemic resilience.

   > **WHO?** GOV, REG, PRISEC

2. **Introduce zero-rated financial apps.** DFS providers in collaboration with telecom operators may introduce zero-rated mobile applications. Provision of cost-free mobile data for digital banking and mobile payment applications will effectively remove the connectivity toll faced by the unconnected.

   > **WHO?** DFSPs, PRISEC

South Africa: Removing barriers to banking

The cost of 1GB of prepaid data is currently more than US$2 on most networks in South Africa. Even if this is brought down to one third of the cost, this remains too expensive for most of the populace in South Africa: over 55 percent of South Africans (30 million people) live in poverty, surviving on less than US$55 per month.

Zero-rating is the process of providing subsidized digital content and/or access to the internet at no charge to the user. One of its key objectives is to increase access to online information and resources for users who cannot afford the costs of data. For digital financial service providers, removing this “hidden cost” to using digital payments is key to unlocking sustainable adoption for the unbanked and vulnerable.

With digital financial inclusion contingent on use of data, many financial service providers, from challengers to incumbents, have innovated to absorb the cost of data associated with using their apps, so that they are zero-rated across all the telcos, enabling continuous, unabated, and free access to digital payments, transfers, and financial services, even if users have depleted their data bundle.

Responsible stakeholders and DFS providers need to continuously discover and look to effectively build solutions that help their users overcome infrastructural barriers that hinder adoption of digital payments and the realization of its promised benefits.
3.5 Designing user-centric products and services

Challenges

Lack of use cases

Of the 78.8 million BB accounts in Pakistan, nearly two thirds are inactive. Evidence shows 28 percent of Pakistanis are formally banked, but this figure does not express the gaping urban/rural divide or express the unique bank ownership characteristics in the country.

The reason for the absence of uptake is a lack of compelling use cases. Merchants have disparate needs and payments cycles according to the nature of their operation. To date these needs have not been met by service providers, who tend towards a one-size-fits-all approach. This is sharply evidenced through merchant interviews, where over 30 percent, predominantly women, felt there were insufficient use cases or incentives for them to transact digitally. DFS providers need to understand the requirements of merchants so that offerings are tailored.

Recommendations

1. Migrate all G2P and P2G transactions to digital platforms.
   G2P has provided a bank account to millions of unbanked and underserved rural population – a notable success being the Ehsaas program. The Government can trailblaze by designing an incentive model so service providers offer a better value proposition to beneficiaries, thereby supercharging account uptake.

"Women merchants interviewed, especially belonging to beauty salons cited that there was neither demand for digital payments from their customers nor did they want to disclose their revenues. All of them, however, agreed that they would be more inclined to adopt if given any incentives."

Group of women merchants, Sukkur

WHO? GOV, BAN, PRISEC
2. **Digitize wages.** Wage digitization lowers security risks and the costs of disbursement for employees and improves access to formal finance for workers, especially women. In Pakistan, over 70 percent of private sector wages are still paid in cash. Mandating the digitization of private sector wages will welcome the unbanked labor force into the formal financial system, providing vital digital liquidity at the start of the value chain.

> **WHO?** GOV, BAN, PRISEC

### 3.6 User experience

To supercharge adoption of digital payments, it is vital to place the merchant user experience center-stage. Merchants explicitly stated that they find the registration process tiresome. The requirement to provide extensive documentation is a principal reason for not opening an account. While none of the merchants interviewed experienced digital onboarding, interviews revealed transaction limits on digitally onboarded merchants were viewed as too low, even for micro merchants.

The regulations set transaction limits on merchant accounts at PKR 50,000 per month without biometric verification and PKR 500,000 per month with biometric verification. The latter converts to less than PKR 20,000 a day. Increasing these limits requires merchants to visit the service provider’s branch, negating the positive user experience that should be digital on-boarding’s key selling point.

The **United Nations Principles for Responsible Digital Payments** identify treating people with fairness as the bedrock upon which responsibility is built. Merchant respondents (especially self-employed individuals in rural areas) noted that representatives at banks did not treat them fairly and hesitated to seek assistance from them.

Respondents stated that online payment platforms are not user friendly as they have complex user interfaces requiring switching between languages for online forms. Many rural respondents across Pakistan also cited language as a barrier to adoption. One such respondent, a woman overseeing businesses for a non-governmental organization, stated that lack of language localization impacted how willing women are to register for a mobile wallet.
Fifty percent of respondents had prior experience of poor grievance redressal issues and therefore deemed all digital payments services as untrustworthy.

**Recommendations**

Diversity of needs requires DFS providers to adopt a differentiated approach to products and services. Offerings will benefit from a tailored approach to design that responds to MSME business cycles, demographic profiles, and risk preferences as a key principle rather than an afterthought.

1. **User-friendly interface.** Design interfaces that interact intuitively and deliver a positive digital experience and forge long-term customer relationships. Providers should consider deeper localization by integrating regional languages, or voice-enabled translation, to ease adoption by the unbanked.

   > **WHO?** DFSPs, PRISEC

2. **Seamless onboarding.** Create seamless digital onboarding to reduce friction and enable swifter onboarding so that customers are ready to transact more quickly. In consultation with SBP, evolve towards a centralized KYC/KYB to reduce costs and eliminate inefficiencies.

   > **WHO?** DFSPs, PRISEC

3. **Make redressal system effective.** Publish visual grievance redressal summaries regularly to confer understanding of the redressal process by users and push the use of multiple channels for easy-to-access recourse points for everyone.

   > **WHO?** DFSPs, PRISEC

“The women here predominantly speak Punjabi or Saraiki. They do not have a functional grasp over Urdu and rely solely on agents for on-boarding.”

Zubaida, School Teacher, Hyderabad
4. **Revisit transaction limits.** Merchant wallets have intrinsically different requirements to an individual’s wallet. Revisit the transaction limits for merchants onboarded digitally to cater to the needs of businesses as per their nature, ideally on a tiered basis, and scale sensibly according to level of KYC/B, appetite, and inflation.

> **WHO?** DFSPs, PRISEC

### 3.7 Enhanced gender focus

DFS providers do not currently view women as a large, independent, and profitable segment for which to design user-centric products and services. Women are often more time constrained than men and are more sensitive to cost. To design better services for women, industry requires a data-based, granular understanding of their wants and needs. Personalized products for women and other marginalized segments are a vital prerequisite to scaling up merchant digitization in Pakistan.

The SBP has recognized that having gender diversity-trained staff as champions at all customer touch points improves women’s trust in DFS providers. However, the need requires stakeholders to go further; DFS design must be done with strong gender intentionality, effectively considering the lived realities of women in Pakistan. The cultural, infrastructural, and societal constraints and challenges must be considered and catered for proactively, and not as an afterthought or edge case.

**Recommendations**

1. **Deliver women-centric experiences.** It is difficult to improve the financial inclusion of women without data to measure the success of efforts. The SBP should publish gender disaggregated data to enable service providers to gain actionable insights into women-led businesses and catalogue their experiences around payments.

> **WHO?** DFSPs, PRISEC

2. **Build for contactless.** Providers should build robust products, processes, and experiences that do not require a physical presence or necessitate human interaction. These experiences can address the limitations and constraints that women and other user segments face, resulting in a more inclusive, accessible, and assistive experience for all users.

> **WHO?** DFSPs, PRISEC
3. Solve for women’s digital readiness. Ownership of digital-ready identity, a biometrically verified SIM, and access to a smartphone are the basic pre-requisites to digital financial inclusion that cannot be solved by a single entity, but instead require a collaborative approach to ensure that all women have an unencumbered path to inclusion in the digital economy, and subsequently, meaningful economic participation.

> WHO? DFSPs, PRISEC

### 3.8 Laser focus on MSMEs by the formal sector

A global report by Mastercard indicates the lack of commitment of merchant service providers in driving the adoption of DFS by small and medium businesses. Mastercard ascribes this fact to their primary target being credit-worthy, higher-income consumers.

Access to credit is made difficult due to the lukewarm approach adopted by the lending institutions and a complex onboarding process for digital payments. Today, most merchants remain unregistered and thus undocumented, rendering it difficult for financial institutions to perform due diligence or lend in the absence of collateral. Hence, banks continue to tilt their strategies in favor of government lending, which accounts for an astonishing 54 percent of all financing in Pakistan (Table 4).

Furthermore, DFS providers’ focus on transaction fees as a revenue stream limits their profitability when charges related to IBFT and merchant discount rate (MDR) are lowered. With the introduction of RAAST (SBP’s Instant and MDR-free Payment System), DFS providers expressed concerns over the viability of their existing business models and incentives for continued investment.

<table>
<thead>
<tr>
<th></th>
<th>PKR (trillions)</th>
<th>Percentage of total lending</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lending to government sector</td>
<td>11,393</td>
<td>54</td>
</tr>
<tr>
<td>Lending to private sector</td>
<td>7,795</td>
<td>37</td>
</tr>
<tr>
<td>Others</td>
<td>2,009</td>
<td>9</td>
</tr>
<tr>
<td><strong>Total lending</strong> (As at December 2021)</td>
<td><strong>21,197</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>
**Recommendations**

1. **Ease access to finance.** Design financial products to address the growth constraints that MSMEs encounter. Offer loans with terms and conditions that are aligned to the requirements of MSMEs – especially women-led MSMEs. Avenues to explore include securing credit against secured transaction records (STR), borrowing against merchants’ movable assets (for instance, receivables), intellectual property, inventory, agricultural produce, petroleum, minerals, or motor vehicles.

   > **WHO?** REG, PRISEC, DFSPs

2. **Value-added products.** Foster market-based solutions covering ongoing costs, while allowing headroom for profit. Providing products like credit or working capital to informal segments yields higher returns for financial service providers, enabling them to reduce their dependency on transaction fees.

   > **WHO?** REG, PRISEC, DFSPs

**3.9 Financially include women merchants**

**Cultural and social issues**

In Pakistan, culture impedes how freely and effectively women can access various financial institutions and services. Usage of formal financial services is more often discouraged due to religious issues in rural areas relative to those in urban markets. According to the GSMA, Pakistan has a marked mobile ownership gender-gap, with women 37 percent less likely than men to own a mobile phone. Only countries like Bangladesh and Nigeria exhibit similar gender barriers to mobile ownership. The study also finds that the 31 percent of women who do not own a mobile phone in Pakistan cited family disapproval as the significant barrier in acquiring a device of their own. 48 Compared to this, only 4 percent of men in the country reported this as a barrier. 49 These findings were strongly corroborated by our field research across Pakistan.

Women across rural Pakistan expressed discomfort travelling alone to withdraw money from their mobile wallets through agents in their neighborhoods. Roughly 60 percent of women surveyed stated that cultural and moral concerns prevented them from being seen outside their homes alone for extended periods of time, but they would often have to wait up to 30 minutes at agents’ stores and stalls to confirm their money had been securely sent.

“Our fathers, husbands, and brothers would disapprove us travelling alone to withdraw money without the help of a male companion.”

Bushra, home-based retailer, Sheikhupura
The women-led MSMEs in rural Pakistan included in this research strongly indicated that they would feel significantly more at ease and inclined to use DFS if they were provided the option of female customer representatives or agents. Currently, 13 percent of the staff of banks and only 1 percent of BB agents are women.\(^70\)

DFS providers during our interviews indicated that key barriers to the financial inclusion of women merchants were finding qualified women in rural areas and the unwillingness of women to work as agents under the prevailing religious and cultural norms.

**Recommendations**

1. **Operationalize the Banking on Equality (BoE) measures.** Guarantee successful delivery of the BoE Equality Initiatives through multilateral commitments, operational support, and constant measurement against targets. Advocacy efforts can be enhanced by addressing the social and cultural impediments faced by women business owners. Enforcement of women’s legal rights related to property ownership will stimulate financing channels.

   > **WHO?** GOV, REG, DFSPs, PRISEC, BAN

2. **Women agents will engender women’s participation.** Provision of women agents at customer touch points will encourage women’s onboarding and mitigate trust issues. DFS providers can incentivize working women in rural areas to work as agents by empowering them to work for multiple operators.

   > **WHO?** DFSPs

### 3.10 Financial viability

**Economics of adoption and MDR**

Merchants emphasized how, out of all the perceived challenges associated with digital payments, the issue of transaction costs proved to be the most persistent.

According to the World Bank, Pakistan ranks 108 among 190 economies in the ease of doing business, improving 28 points from 136 in 2018. Pakistan has one of the highest policy rates in the region (15 percent as of August 2022) followed by high electricity costs and frequent power outages. The cost of doing business in Pakistan is higher than regional peers. Micro and small merchants operate on an average of 8–10 percent gross margins, with net margins closer to 4–5 percent.\(^71\)
As a result, merchants, especially those operating electronic and pharmaceutical stores, surcharge card users with MDR, urging them to withdraw cash from nearby ATMs and make their payments in cash. MDR is often negotiated by larger merchants in urban areas (large grocery chains, etc.) on favorable terms with their service providers. This dynamic makes cash appear free of cost and acts as a major impediment in digitizing payments for smaller merchants who already operate on thinner margins.\(^2\)

More recently, however, even large corporate retailers like the oil marketing companies have discontinued or discouraged card-based payments at refueling stations, explaining the MDR they pay is eroding their fixed margins.

POS payments operate on a four-party model in Pakistan. The distribution of MDR among the service providers, issuers, and acquirers is shown in Figure 7.

Figure 7. Distribution of MDR

The MDR in Pakistan has been restricted to a rate of 1.5–2.5 percent per transaction. The bulk of the MDR (around 1.15 percent) is taken by the issuer, the switch fee is around 0.1 percent, and the remaining 0.25 percent is the acquirer’s margin.\(^3\) In India, MDR charges are capped at 0.4 percent for small merchants and 0.9 percent for all merchants on card-based transactions. It is much lower on QR payments.\(^4\)
3. Challenges and recommendations

Table 5. MDR on POS in Pakistan and other countries in the region

<table>
<thead>
<tr>
<th>Country</th>
<th>MDR on POS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pakistan</td>
<td>1.5–2.5%</td>
</tr>
<tr>
<td>India</td>
<td>RuPay (Local): 0%; Mastercard/Visa: 0.4–0.1.6%</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>1.6%</td>
</tr>
</tbody>
</table>

**Recommendations**

1. **Tiered MDR.** SBP, in partnership with DFS providers, can drive a tiered approach to MDR based on size, segment, or sector of merchant’s business – especially those with thinner margins. A balanced approach is required so that acquirer and scheme margins are protected. In India, MDR charges are capped at 0.4 percent for small merchants and 0.9 percent for all merchants on card-based transactions. Additionally, charges there are capped at 0.3 percent for small merchants and 0.8 percent for all merchants when transacting through QR codes.

> WHO? REG, BAN, PRISEC

2. **Promote local schemes.** DFS providers can encourage customers to opt for local scheme options when choosing payment card services. This especially applies for customers with high local usage where transactions can be routed through local payment infrastructure.

> WHO? DFSPs
3.11 Taxation

Many respondents during stakeholder interviews agreed that pressing for taxation had an inverse relationship with digital adoption of payments. Whilst the adoption of digital tools by small businesses naturally leads towards early stages of formalization, the fear of documentation and taxation looms large in an economy where almost 56 percent of the GDP is estimated to be undocumented and largely operating on cash.

The MSMEs interviewed for this study cited the burden of tax compliance as a bigger hurdle than the expected tax liability, especially when lacking the necessary resources and skill set for compliance with tax obligations. In many cases, MSMEs are required to pay penalties for non-compliance following lengthy legal proceedings. In many developing economies, the costs of tax compliance, combined with a lack of recourse, are a major deterrent to tax filing and the decision to become “formal”. By extension, this aversion to any form of documentation acts as a barrier to the adoption of digital payments and tools.

Digital payments, which by nature are documented and traceable, are therefore perceived with a great deal of suspicion by MSMEs, who prefer to continue to operate in the “shadows” of the economy by utilizing untraceable cash.

To effectively drive the adoption of digital payments and streamline future tax collection efforts, regulatory authorities must work together to effectively de-link the adoption of digital payments from the complex issues of business formalization and taxation.

Fear of disclosure

On the demand side, fear of taxation is a significant impediment to the digitization of payment systems in Pakistan. There is a strong perception in MSMEs that digitization will lead to documentation of their businesses and eventually taxation. This notion was further reinforced by the statement from the government at the launch of RAAST (SBP’s Instant Payment System) that the platform aims to increase financial inclusion, leading to documentation of economy and therefore reducing tax evasion.

“I have a POS machine available with me but I only use it occasionally for customers who can’t pay in cash and want to make the purchase using their credit card. I don’t know of the implications, but I just do not want to disclose my income.”

Zaheer, 33, Mobile Shop Owner
There is an industry-wide fiction that transaction-level monitoring and data exchange occurs between banks and tax authorities. Such mechanisms, though provisioned in law, are inhibited by banking privacy statutes, legal precedents on reducing audit stress, and a lack of technical facility within the tax authorities. The Tax Audit Policy, FBR technical constraints, and banking privacy provisions prevent a fluid exchange of data that may be used for picking audit cases at the SME level.

“Merchants are not ready to file tax returns and feel digital payment acceptance reduces the deliberate financial opacity that they instrumentalize to protect their margins. This is largely due to the complexity in filing returns, high rate of taxation and exploitation by junior cadre tax officials”, a taxation expert explained.

Coordination among stakeholders

As digital payments increasingly connect DFS providers, governments, and development organizations with other stakeholders, it is essential that actors assume responsibility for their value chains. Stakeholders pointed out a lack of coordination between different government department as an impediment to their daily activities.

Policy makers on the other hand cited “political instability” as the principle reason of weaknesses in long-term policy implementation.

“It’s not just about tax rates but overall cost of tax compliance, you become 20 to 25 percent more expensive than your next-door neighbor so tax is a huge cost for merchants.”

Adeel, 41, Leather Wear Store Franchisor

Uneven playing field for merchants

The benefits of digital compared with its impact on businesses deriving from being documented are marginal. Fear of becoming uncompetitive as a tax compliant business is an enormous worry for MSMEs.
Many merchants argue that paying tax will place them at a competitive disadvantage compared to peers who do not. As a policy maker explained, during a stakeholder interview: “Merchants don’t pay 17 percent tax as they claim, and taxation is input-output adjusted. The argument that it’s unfair to those that do pay taxes still doesn’t hold as they will still contest the high MDR. The real issue that nobody wants to address is what the retailer margin can accommodate in terms of digital payments.”

The input/output adjusted tax rate at the retail level amounts to 3–6 percent, while MDR ranges from 1.5–3 percent. This 9 percent incremental cost (if avoided) confers a 30–100 percent increase in retailers’ margins. SKU-level cost adjustment and tax evasion are the primary mechanisms used by retailers on supplies from unregistered distributors to accommodate this cost.

On the supply side, heavy taxation on POS devices discourages service providers as they do not want to pay taxes on every dollar that they spend to digitize the economy.

“Certain incentives such as tax holidays on import of POS machines that were previously implemented and later withdrawn should be reintroduced to incentivize the service providers into investing in digitization of the economy.”

Representative, Emerging Payment Service Provider
**Recommendations**

1. **Coordinated national action plan.** A coordinated approach to executing a National Digital Agenda across all governmental departments will realize the full commercial potential of MSME merchants more quickly. It will also broaden the tax base in a consent-based way, enabling government to plan more confidently around future policy initiatives.

   > **WHO?** GOV, BAN, PRISEC

2. **Fiscal incentives.** The Federal Board of Revenue (FBR) may lower sales tax rates for consumers on payments made through digital channels, introduce tax breaks for informal MSMEs, and reduce taxes on POS machines and transaction, which represent 30 percent of service providers’ costs. These measures, when sustained, drive demand and ease supply side constraints for digital payments.

   Reintroduce federal excise duty (FED) exemption on MDR to payment service operators (PSOs), payment service providers (PSPs), and electronic money institutions (EMIs) authorized by the State Bank of Pakistan, which currently only applies to banking companies under the 2022 Finance Bill,\(^1\) to create a level playing field with cash.

   > **WHO?** GOV, MIN, REG

3. **Level up understanding of incentives.** FBR can educate the market on current incentives for digital payment adoption and counter the misconception that digitization leads to taxation. Incentives are only used if they are understood.

   > **WHO?** GOV, MIN, PRISEC, DFSPs
This study employs primary and secondary research to gauge the current state of the digital payments ecosystem in Pakistan through the lens provided by the United Nations Principles for Responsible Digital Payments. It then considers the salient challenges in the landscape faced by supply side players and offers recommendations for their resolution.

On-ground research consisted of over 350 merchant interviews in focus groups across rural and urban areas, covering formal and informal businesses. These discussion groups were arranged in Karachi, Hyderabad, Sukkur, Multan, Lahore, Sheikhupura, Rawalpindi, and Peshawar through collaborations with local development organizations and associations working with our targeted segments of merchants. Supplementary research comprising one-on-one qualitative interviews was conducted with 100 additional small entrepreneurs in urban areas that also included e-commerce merchants and women-led businesses. The data collected is qualitative, providing insights on current usage of DFS by MSMEs.

The research utilizes insights collected from in-depth interviews with key stakeholders including policy makers, payment service providers, and industry analysts to capture their perspectives on challenges and opportunities around digital payments. The list of interviewees is provided in Annexure B.

The report, however, does not claim to be an exhaustive representation of the current state of Pakistan’s digital financial landscape.

Table 6. Sample distribution

<table>
<thead>
<tr>
<th>Research methodology</th>
<th>Men</th>
<th>Women</th>
<th>Rural</th>
<th>Urban</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Merchant interviews in focus groups</td>
<td>45%</td>
<td>55%</td>
<td>60%</td>
<td>40%</td>
<td>350</td>
</tr>
<tr>
<td>Individual in-depth interviews</td>
<td>65%</td>
<td>35%</td>
<td>-</td>
<td>100%</td>
<td>100</td>
</tr>
<tr>
<td>Stakeholder interviews</td>
<td>82%</td>
<td>18%</td>
<td>-</td>
<td>-</td>
<td>22</td>
</tr>
</tbody>
</table>
## Annexure B
### List of interviews

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Interviewees</th>
<th>Organization/Affiliation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Muhammad Imaduddin</td>
<td>State Bank of Pakistan</td>
</tr>
<tr>
<td>2</td>
<td>Shoukat Bizenjo</td>
<td>State Bank of Pakistan</td>
</tr>
<tr>
<td>3</td>
<td>Umair Ahmad, Joint Director</td>
<td>State Bank of Pakistan</td>
</tr>
<tr>
<td>4</td>
<td>Faiqa Naseem, Deputy Director</td>
<td>State Bank of Pakistan</td>
</tr>
<tr>
<td>5</td>
<td>Sajidullah Siddiqui (Ex-DG Retail)</td>
<td>Federal Board of Revenue</td>
</tr>
<tr>
<td>6</td>
<td>Ali Saeed</td>
<td>Federal Board of Revenue</td>
</tr>
<tr>
<td>7</td>
<td>Mona Mehfooz Baloch</td>
<td>Sindh Revenue Board</td>
</tr>
<tr>
<td>8</td>
<td>Musarrat Jabeen, Head of Policy, Regulation and Development</td>
<td>Securities and Exchange Commission of Pakistan</td>
</tr>
<tr>
<td>9</td>
<td>Saad Niazi, Co-founder and COO</td>
<td>Keenu</td>
</tr>
<tr>
<td>10</td>
<td>Atyab Tahir, Country Head</td>
<td>Mastercard</td>
</tr>
<tr>
<td>11</td>
<td>Omar Moeen Malik, Head of Product</td>
<td>Telenor Easypaisa</td>
</tr>
<tr>
<td>12</td>
<td>Farwah Tapal, Co-Founder</td>
<td>Oraan</td>
</tr>
<tr>
<td>13</td>
<td>Fawad Abdul Kader, CEO</td>
<td>PayMob</td>
</tr>
<tr>
<td>14</td>
<td>Danish A. Lakhani, CEO</td>
<td>NayaPay</td>
</tr>
<tr>
<td>15</td>
<td>Umer Ansari</td>
<td>1 Link</td>
</tr>
<tr>
<td>16</td>
<td>Umair Shahid</td>
<td>1 Link</td>
</tr>
<tr>
<td>17</td>
<td>Owais Sohail, Head Digital Payments and B2B Alliances and Hassan Awan</td>
<td>Habib Bank Limited</td>
</tr>
<tr>
<td>18</td>
<td>Shariq Mubeen</td>
<td>Meezan Bank Limited</td>
</tr>
<tr>
<td>19</td>
<td>Saeed Khan, CEO</td>
<td>ASA Pakistan</td>
</tr>
<tr>
<td>20</td>
<td>Syed Fawwad Ahmed, Director Strategy and Digital Transformation</td>
<td>Unilever</td>
</tr>
<tr>
<td>21</td>
<td>Asfandyar Farrukh</td>
<td>Chainstore Association of Pakistan and HUB (Urban Brands)</td>
</tr>
<tr>
<td>22</td>
<td>Ali Khizar</td>
<td>Business Recorder</td>
</tr>
</tbody>
</table>
## Annexure C

### Key policy highlights

<table>
<thead>
<tr>
<th>Policy/initiative</th>
<th>Highlights</th>
</tr>
</thead>
<tbody>
<tr>
<td>Branchless Banking Regulations</td>
<td>The regulations introduced new branchless banking players and the development of an agent network for the delivery of financial services to the underserved. Following rapid uptake, the regulations were revised in 2011 and again in 2016.</td>
</tr>
<tr>
<td>Regulations for Security of Internet Banking</td>
<td>With rising cyber-crimes and online fraud in the country, the SBP updated the regulations to mitigate newly emergent risks in an evolving landscape. The regulations cover security aspects of mobile banking applications and the usage of Application Programming Interfaces (APIs).</td>
</tr>
<tr>
<td>Enhanced National Financial Inclusion Strategy (NFIS)</td>
<td>The NFIS lays out the national vision, framework, action plan, and targets to drive financial inclusion in Pakistan. The NFIS aims to achieve inclusive economic growth through targets set around 1) Enhanced usage of digital payments 2) Enhanced deposit base 3) Increased SME finance 4) Increased agricultural finance and 5) Enhanced share of Islamic banking.</td>
</tr>
</tbody>
</table>
| National Payment System Strategy                       | The National Payment Strategy provided a roadmap to design a digital national payments system to enhance financial stability and increase financial inclusion. The NPSS makes the following recommendations:  
  - Create an enabling legal and regulatory regime for the payments system  
  - Strengthen payment systems oversight  
  - Develop and modernize the national payments’ infrastructure  
  - Digitize government payments  
  - Enhance the efficiency of the retail payments market  
  - Bring efficiency in remittance payments  
  Recent regulatory initiatives taken by the SBP are part of the road map set in the NPSS. |
<p>| E-Commerce Policy                                      | The policy covers the promotion of e-Commerce generally, including: the regulatory environment, financial inclusion and digitization via payments infrastructure, youth empowerment, SMEs, consumer protection, taxation, information and communication technology (ICT) infrastructure and logistics. |
| Rules for Digital On-Boarding of Merchants             | The SBP formulated these regulations to simplify due diligence procedures that otherwise required a long list of documentation and even longer procedures. The digital on-boarding is applicable for only self-employed merchants with restricted merchant account balance and transactions limits. |</p>
<table>
<thead>
<tr>
<th>Policy/initiative</th>
<th>Highlights</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulations for Electronic Money</td>
<td>The payment service provider (PSP) licensing regime has provided the regulatory framework for Fintech platforms enabling payment settlement systems between participating financial service providers. After establishing the PSP licensing regime, the SBP announced the licensing regime for electronic money institutions (EMI), enabling fintechs to provide payment services to individuals. However, for fintechs to initiate lending services, a Non-Bank Financial Company (NBFC) license is required from the SECP.</td>
</tr>
<tr>
<td>Institutions</td>
<td></td>
</tr>
<tr>
<td>Banking on Equality</td>
<td>The SBP launches the Banking on Equality policy to reduce the gender gap in financial inclusion by inculcating women-friendly business practices in the financial sector. In line with the UN Principles for Responsible Digital Payments and Reaching Financial Equality, the policy promotes gender diversity in FIs and customer touch points, sets targets for FIs to apply a gender lens to develop women-centric products and services and encourages the collection and use of gender disaggregated data.</td>
</tr>
<tr>
<td>SME Policy</td>
<td>The national SME policy provides recommendations to support SME growth as part of a holistic framework. The Policy framework is based on two central pillars: reforming the policy and regulatory environment and addressing SME market constraints, both demand and supply side.</td>
</tr>
<tr>
<td>RAAST Payment System</td>
<td>RAAST, launched by the SBP, is Pakistan’s first instant payment system set to enable end-to-end digital payments among individuals, businesses, and government entities instantly. RAAST can on-board participants, including banks, and merchants, Electronic Money Institutions through Application Programming Interfaces. It aims to address key challenges within the payment ecosystem including high cost of transactions, limited interoperability, security, and user experience.</td>
</tr>
<tr>
<td>Regulations for Payment Card Security</td>
<td>The regulations mandated the transition from the magnetic stripe standard to the more secure EMV chip and personal identification number (PIN) compliant standard. In its recent update it disallowed fallback transactions on card processing infrastructure, to prevent skimming frauds, mandated the use of EMV 3D secure for e-commerce transactions, included policy measure on contactless payments, and set a limit for authorizing transactions without requiring a PIN.</td>
</tr>
<tr>
<td>Standard for Interoperable QR Code</td>
<td>As part of the SBP’s drive to promote inclusion, innovation, and modernization of payment systems in the country, it has issued standards for QR code-based payments in Pakistan to accelerate digitization of retail payments. QR payments are a key enabler of low-cost payments digitization. The current variations will facilitate issuance and adoption of QR based P2P and P2M payments.</td>
</tr>
</tbody>
</table>
Annexure D

Digital Payment Acceptance Incentives Analysis

<table>
<thead>
<tr>
<th>Public sector</th>
<th>Fiscal and financial incentives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Merchant fiscal incentives</td>
<td><strong>Pakistan:</strong> FBR initially granted tax credit on POS installation that resulted in the adjustment of PKR 150,000 per POS device. (^2) This incentive was later withdrawn.</td>
</tr>
</tbody>
</table>
| Subsidized POS terminals | **Pakistan:** FBR initially waived 15% sales tax, as a result merchants benefited from 30% cost reduction on installation of a POS machine. However, in the sixth IMF Review, FBR withdrew the exemption.  
**India:** Government subsidized MDR on payments made through debit cards, unified payment interface (UPI) and Aadhaar-enabled payment systems up to Rs 2,000 for two years. |
| Consumer fiscal incentives (VAT/ income tax reductions) | **Pakistan:** Punjab Revenue Authority offer consumers reduced rate of General Sales Tax (GST), i.e. 5% on card payments in restaurants. \(^3\) |
| Lotteries | **Pakistan:** Prize Scheme on POS System introduced through Finance Act 2021 to encourage customers to use digital channels. FBR introduced prize scheme for shoppers of POS integrated retailers.  
**India:** National Payment Corporation of India introduced two lotteries for specific limits of making electronic payments. |
| Consumer protection and financial literacy | **Pakistan:**  
- The SBP issued the Mobile Applications (Apps) Security Guideline  
- Mandated (EMV) chip and PIN compliant cards  
- Enablement of ecommerce transactions using international 3DS security standards for chip and PIN transactions  
- Mandatory 2-Factor Authentication for digital banking channels and free transaction alerts  
- Cyber threat intelligence and information sharing between banks and with SBP on 24/7 basis  
- Mandatory deployment of real-time fraud monitoring tools by banks to detect fraudulent activities  
- Disallowing fallback transactions on card processing infrastructure to prevent skimming frauds.  
**Malaysia:** Migration from signature to PIN verification for added security |
| Supply chain digitization | **Pakistan:** Fintechs like Haball working on digital invoicing and supply chain |
### Regulatory

**Encourage merchant formalization**
- **Pakistan:** SMEDA’s SME registration portal provided easier registration of businesses to realize benefits like formal financing.

**Disincentives for cash-cash transaction limits**
- **Pakistan:** Finance division prohibited cash withdrawals except some employee related deductions, e.g. pensions. Payments to employees, contractors, vendors, suppliers were mandated through direct credit or through crossed cheques until the online credit system is available.\(^{84}\)

**Interchange fee and merchant discount rates**
- **Pakistan:** Reduction in interchange fee on debit card payments by SBP. SBP fixed the MDR within the range of 1.5–2.5% on POS transactions. India: MDR capped initially at 0.25/0.5% and increased to 0.4/0.9% for swipe transactions, and 0.3/0.8% via QR code for small/all merchants respectively. **Malaysia:** Promoted a competitive payment card market by enabling differentiated and transparent MDRs for merchants. Introduced ceilings on debit cards at cost level and on credit cards at slight above cost level for infrastructural development. Possible reductions in ceilings were tied to industry targets on card-based transactions.

**Mandated acceptance of electronic payments**
- **Pakistan:** FBR mandated Tier-1 retailers to install POS machine at every notified outlet and disallowed 60% input tax credit on those who have still not integrated their businesses with the FBR’s POS system.

**Mandated disbursement of wages and salaries by electronic payments**
- **Pakistan:** Any salary paid or payable exceeding PKR 25,000 per month has to be made through cross cheque, digital mode, or direct transfer of funds to the employee’s bank account.

In their 15 October 2021 Circular, SBP mandated PSPs and PSOs to offer digital payments solutions to every business including IBFT, online bill/invoice sharing, card payments, QR codes, mobile payments, amongst all others.

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### Other

**Government adoption of electronic payments**
- **Pakistan:** Social welfare cards issued by banks on behalf of BISP, Employees Old Age Benefits Institution (EOBI), Ehsaas and other government organizations and schemes. Government institutions like NADRA and FBR’s acceptance of digital payments from public.

### Ecosystem Development

**Interoperability and standardization**
- **Pakistan:** 1 Link Payment Gateway and Switch Development of instant payment system RAAST Standard for interoperable QR code for P2P and merchant payments.
<table>
<thead>
<tr>
<th>Public Sector</th>
<th>Value added services</th>
</tr>
</thead>
</table>
| **Credit Productivity Solutions** | **Pakistan:** Commercial banks, digital financial institutions (DFIs) and EMIs offer credit services as part of their business  
**India:** A mobile-based payment and lending platform, Ftcash, offers loans to merchants by leveraging payment data trends  
**Pakistan:** Fintechs Easykhata Apps, etc. |
| **Technology innovations and new business models** | **Pakistan:** Emerging fintechs are offering P2P lending platforms -products like advance salaries, digital wallets, etc.  
**India:** Ftcash, a mobile-based payment startup, allows clients to select a payment method using link sent via text and checkout either via mobile app or scanning QR code. |
| **New products and services** | **Pakistan:** Fintech players like Haball working on digital invoicing  
**India:** New startups like Ftcash offer onboarding in a record time of 5 minutes for merchants. Ftcash provides clients with various options to settle their payments and offers loans to merchants through an undisclosed financial partner. The platform acquired 25,000 merchants in their first 18 months as a result.  
**Malaysia:** Adoption of contactless functionality for greater convenience |
| **Improving the product experience** | **Pakistan:** National Financial Literacy Program (NFLP)  
**Malaysia:** E-payments roadshow and township campaigns |
| **Supply chain digitization** | **Pakistan:** Innovation facility was first initiated by SBP and later taken over by karandaaz, who employ incubation centers at provincial levels and facilitate small tech-based businesses with funds through partnerships with banks. However, no evolutionary interventions have been initiated in this category.  
**Indonesia:** DFIs in collaboration with Visa launched an acceptance development fund that covered over 20 electronic payments acceptance (EPA) programs aimed at incentivizing POS adoption among new merchants and promoting emerging channels such as eCommerce, mCommerce, mPos, and contactless. The program deployed 88,000 new POS terminals and expansion in new channels, spurring a 30% acceleration in payment volume growth.  
**Malaysia:** The central bank allowed network operators to establish a Market Development Fund for managing an additional 0.1% interchange fee over credit card transactions. As a result, POS terminal annual growth tripled from 6.8% (2011–2014) to 20.4% (2015–2017). Debit card transactions have also been growing at record rates. |
Annexure E

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Annexure F
List of acronyms

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>API</td>
<td>Application programming interface</td>
</tr>
<tr>
<td>APR</td>
<td>Annual percentage rate</td>
</tr>
<tr>
<td>BB</td>
<td>Branchless banking</td>
</tr>
<tr>
<td>BISP</td>
<td>Benazir Income Support Program</td>
</tr>
<tr>
<td>BoE</td>
<td>Banking on Equality</td>
</tr>
<tr>
<td>CAGR</td>
<td>Compounded annual growth rate</td>
</tr>
<tr>
<td>CAPEX</td>
<td>Capital expenditure</td>
</tr>
<tr>
<td>CGAP</td>
<td>Consultative Group to Assist the Poor</td>
</tr>
<tr>
<td>DFIs</td>
<td>Digital financial institutions</td>
</tr>
<tr>
<td>DFS</td>
<td>Digital financial services</td>
</tr>
<tr>
<td>EMIs</td>
<td>Electronic money institutions</td>
</tr>
<tr>
<td>EOBIs</td>
<td>Employees Old Age Benefits Institution</td>
</tr>
<tr>
<td>EPA</td>
<td>Electronic payments acceptance</td>
</tr>
<tr>
<td>FBR</td>
<td>Federal Board of Revenue</td>
</tr>
<tr>
<td>FED</td>
<td>Federal excise duty</td>
</tr>
<tr>
<td>GSMA</td>
<td>Global System for Mobile Communications Association</td>
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<tr>
<td>GST</td>
<td>General sales tax</td>
</tr>
<tr>
<td>IBFT</td>
<td>Inter-bank fund transfer</td>
</tr>
<tr>
<td>ICT</td>
<td>Information and communication technology</td>
</tr>
<tr>
<td>KYB</td>
<td>Know your business</td>
</tr>
<tr>
<td>KYC</td>
<td>Know your customer</td>
</tr>
<tr>
<td>MDR</td>
<td>Merchant discount rate</td>
</tr>
<tr>
<td>MOITT</td>
<td>Ministry of Information Technology and Telecommunication</td>
</tr>
<tr>
<td>MSMEs</td>
<td>Micro, small and medium enterprises</td>
</tr>
<tr>
<td>NADRA</td>
<td>National Database and Registration Authority</td>
</tr>
</tbody>
</table>
NFLP  National Financial Literacy Program
OPEX  Operating expenditure
OTC  Over-the-counter
P2G  Person-to-government
PECA  Prevention of Electronic Crimes Act
PIN  Personal identification number
POS  Point of sale
PSO  Payment service operator
PSP  Payment service provider
PTA  Pakistan Telecommunication Authority
QR  Quick response
RAAST  The State Bank of Pakistan's instant payment system
SBP  State Bank of Pakistan
SECP  Securities and Exchange Commission of Pakistan
SLA  Service level agreement
SME  Small and medium enterprise
SMEDA  Small and Medium Enterprises Development Authority
STR  Secured transaction records
UPI  Unified payment interface
Endnotes

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These numbers do not account for multiple SIM ownership.


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State Bank of Pakistan, for the purposes of credit lending, defines microenterprises as projects or business run by microentrepreneurs who are either self-employed or employ few individuals involved in trading, manufacturing, services, or agriculture that may lead to livelihood improvement and income generation.


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The Better Than Cash Alliance is a United Nations-based partnership of governments, companies, and international organizations that accelerates the transition from cash to responsible digital payments to advance the Sustainable Development Goals.

www.BetterThanCash.org