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Effects of fintech adoption on banks' financial performance - A case of Pakistan

By:

Name: Ilsa Shahid **Enrollment # 01 – 221242 - 003**

Supervisor:

Dr. Khalid Hussain

Bahria Business School

Bahria University Islamabad

Fall 2025

This research aims to analyze the effects of fintech adoption on the financial performance of banks (conventional and Islamic) in Pakistan. It focuses on three key dimensions: profitability, operational efficiency and credit risk management of a bank. As the banking sector undergoes a technological and digital transformation, fintech tools such as digital payment systems (mobile banking apps and Raast Pakistan's instant payment system), digital wallets and branchless banking platforms, QR based payments, internet/mobile banking, and automated credit assessment systems are increasingly reshaping and redefining the traditional banking operations and practices. Studying the annual reports of all major Pakistani commercial banks (Islamic and conventional) over the period 2014–2024, this research uses quantitative methods to analyze the relationship between fintech adoption and core performance indicators, including Return on Assets (ROA), Return on Equity (ROE), operating efficiency (operating expenses divided by operating income), and non-performing loan (NPL) ratios. The results reveal that fintech adoption contributes positively to banks' profitability and operational efficiency. It also enhancing their ability to manage credit risk through advanced data analytics and faster decision-making processes. Statistical findings, however, show positive impact of fintech adoption on ROE only. The study provides valuable insights for bank managers, policymakers, and regulators on how to leverage fintech as a strategic tool to strengthen institutional (bank) performance and efficiency. Furthermore, it adds to the growing body of literature on fintech's transformative role in emerging economies, particularly within the context of Pakistan's evolving financial ecosystem.

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1. Introduction:

The global financial landscape is being transformed by the rapid evolution of Financial Technology (fintech), which integrates technological innovation with financial services to deliver safer, faster and more accessible solutions to its customers (Zhao et al., 2022). Adoption of fintech has enabled banks serve customers more efficiently and satisfaction levels among customers have also boosted. Fintech has provided easy to use, faster and accessible solutions overcoming the problems and delays faced by the traditional banking practices. Fintech refers to "technologically enabled innovation in financial services that could result in new business models, applications, processes, or products with a material effect on financial markets and institutions" (European Commission, 2018, as cited in Rupeika Apoga & Thalassinos, 2020). With fintech's growing scope and adoption, banks are now providing digital services such as mobile banking, internet banking, e-wallets and automated software to process credit related requests of its corporate, commercial and SME customers and assess credit risk more efficiently and with precision to decrease NPL ratio across the banking sector.

With fintech's evolving and expanding scope worldwide, banks are increasingly adopting digital technologies to remain competitive among peers and meet the evolving expectations of customers prudently. Major financial institutions worldwide and most of FIs in Pakistan are now relying on integrated digital solutions like internet banking, mobile banking applications, P2P (peer-to-peer systems), blockchain-enabled platforms, and advanced software and analytics for credit-related processing and decision making. Such tools have been devised not only to streamline customer interactions but also increase operational efficiency by automating loan processing, improving the accuracy of credit risk assessments, and strengthening internal controls. Resultantly, fintech is playing a crucial role in helping banks achieve optimum efficiency, serve customers in less time and reducing the ratio of non-performing loans (NPL) ratios by effectively utilizing data-driven models, machine learning algorithms and real time monitoring systems that provide early warning signs for credit deterioration for example ORR model calculated Obligor Risk Rating and banks devise their own matrix as to which ratio depicts poor credit quality of obligor and vice versa. Financial inclusion is being promoted by

banks to reach far flung previously underserved areas by making digital channels and increasing outreach so that maximum customer satisfaction is attained.

In the case of Pakistan, the banking sector has embraced digitalization with an increased pace during recent years, especially following the regulatory developments and policies by State Bank which were aimed at modernizing the financial services and facilities. The launch of 'Branchless Banking Regulations' in 2018 and the State Bank of Pakistan's 'Mobile Banking Regulatory Framework' in 2007 played a crucial role in shaping the trajectory of digital banking in Pakistan (Butt & Khan, 2019). Introduction and implementation of such policies by SBP has provided as well-structured environment for financial innovation by encouraging the emergence of a range of digital payment platforms, mobile banking applications, and automated credit assessing systems which would ultimately serve both urban and rural populations. By introducing regulatory clarity and operational guidelines regarding digital implementation these frameworks tend to reduce barriers to entry for technology-driven solutions by allowing banks to diversify their options in order to explore new service delivery options.

Major banks in Pakistan like Meezan Bank, Habib Bank Limited, United Bank Limited, Askari Bank among many others have developed their own mobile banking apps like HBL's Konnect, Askari Digital App, UBL digital safe banking app etc which enable their customers to conduct transactions like pay bills, transfer funds simply by using their smartphones efficiently and in lesser time.

Fintech is on the rise and such innovations has increasingly reshaped the whole scenario of customers interacting with banks to manage their financial matters. For example, the automated risk-rating systems are able to analyze huge quantities of data to swiftly measure changes in the dynamics of the companies allowing for credit decisions to be more efficient. Also, other new innovative technologies have been introduced like the QR based payments and vendors adopting digital platforms for their everyday transactions. These transactions have now become less costly and time saving boosting customer satisfaction and enhancing overall efficiency of operations that guide every day processes.

Now seeing the benefits of fintech all areas of market from banks to financial institutions continue to compete and collaborate in order to drive innovation that will shape the future of financial services in Pakistan.

Collaborations with third parties are also increasing also hinting at a rapid evolution aimed at guiding banks to achieve profitability. For instance, after entry of the UAE-based Mashreq in Pakistan several banks have formed alliances with Mashreq to gain competitive edge over others.

Several other collaborations have been initiated like the Bank Alfalah & Paymob (digital payments partnership), Bank Alfalah & QistBazar (Embedded Finance / BNPL Buy-Now-Pay-Later) collaboration, Faysal Bank & OPay, Faysal Bank & Smart1-Tech payment solutions, Meezan Bank & Payoneer etc.

Furthermore, operational efficiency improves through real-time service delivery and automation thereby leading to lower cost-t-income ratios and branch operations which are leaner (Anggreni et al., 2020). Finally, credit risk management also benefits from advanced data analytics that reduce default probability, improve loan underwriting and enhance early warning systems (Hassan & Misrina, 2021).

Fintech has been a cornerstone for many sectors worldwide and has allowed industries to gain new heights of profitability. Banks globally are now adopting fintech to reduce reliance on physical infrastructure. This digitalization also enables easy to use interface for the users thereby allowing transactions worth billions of rupees or dollars to be processed instantaneously. This is the breakthrough the world has witnessed which has transformed the way companies work and interact. Such an interaction is essential in confirming progress of companies. Digitalization is rapidly shaping the structure of every sector especially banking.

Technologies worldwide have even though reached new heights but this transition in developing countries like Pakistan is still in transition phase. The population is still so prone to traditional ways of doing things and interacting physically that adoption of such new techniques will take time. Also new technology is not being administered by Pakistan itself hence third party collaborations are needed and foreign support is also required in this regard.

However, this fact needs no further confirmation that digitalization is the future of the banking sector and without it countries cannot compete at a global level.

Major financial institutions worldwide and most of FIs in Pakistan are now relying on integrated digital solutions like internet banking, mobile banking applications, P2P (peer-to-peer systems), blockchain-enabled platforms, and advanced software and analytics for credit-related processing and decision making. Such tools have been devised not only to streamline customer interactions but also increase operational efficiency by automating loan processing, improving the accuracy of credit risk assessments, and strengthening internal controls.

By doing so, it offers fresh evidence from a rapidly evolving market that sits at the crossroads of traditional banking and fintech innovation.

Second, this paper comes up with a bank-level proxy of fintech adoption to measure the degree to which the incorporation of fintech influences the overall performance of banks. Although previous studies generally use various metrics to determine fintech transformation, including the volumes of digital transactions or the number of users of mobile-app, the banking situation in Pakistan lacks sufficient data, which is why a single measure can be more feasible.

In line with the already existing literature (e.g., Phan et al., 2020; Zhao et al., 2022), the ratio of IT spending and total assets of a bank is what we call the fintech investment ratio. This measure is the ratio of how much countries invest in information systems, digital infrastructure, and technology-oriented innovation, which are primary elements of fintech according to the Financial Stability Board (2017). The ratio allows the comparison of IT expenditure across banks by normalizing it by the size of the bank and allows significant cross-bank analyses, as well as a strong parameter of in Beyond ROA/ROE - The authors carefully extend the definition of the bank performance. Instead of considering the success as purely a single profitability ratio, the research uses a collection of indicators, including efficiency (e.g., cost-to-income and operating expense ratio), risk (e.g., the non-performing loan (NPL) ratio), and other profitability (ROA, ROE, net interest margin) indicators.

The driver of fintech adoption - The central hypothesis is that a greater adoption of fintech solutions, i.e. online banking, mobile payments, online credit solutions and AI-based decision-

making tools, is a driving force of the redefinition of the aforementioned performance dimensions.

Empirical results gained in Pakistan - By examining a sample of Pakistani banks across a number of years, the research provides information that is particularly useful to domestic policy makers and top managers in the local banking industry.

New approach to methodology - The authors utilize a mixed-methods design, which consists of quantitative panel regressions with firm-fixed effects to isolate the effect of fintech on NPLs and other financial ratios, alongside qualitative case study of banks that have gone further to pursue digital transformation to explain the mechanisms behind the observed quantitative effects.

Policy and managerial implications - The findings can be used by the regulators to develop frameworks that are friendly to fintech, including sandbox regulations and open-banking conventions, that might reduce NPLs. The bank leaders can compare their digitalisation processes with the metrics discussed in the study to determine their competitive positioning.

Fintech is not an additional value addition; it can be a significant addition to the risk profile and overall performance of a bank. The paper presents some hard, empirical facts, which ought to guide the design of policy as well as the strategic planning in the banking industry in Pakistan. Banks adopting fintech worldwide are also forcing developing economies to achieve relative results if not equivalent hence adoption of fintech by banks is the only way to a successful future.

1.1 Background of the study:

The enormous role played by FinTech has become a major driving force in the banking sector today, where mobile gadgets and cloud platforms have become the new branches of the old ones. The digitalization efforts of banks have been enhanced in the Pakistani setting, where smartphone penetration is rising, the digital-banking framework established by the State Bank of Pakistan, and the COVID-19 pandemic have jointly increased the pace of their digitalization. However, scholarly literature and business practice are split over how much this digital transformation improves the sustainability of banking institutions on the balance-sheet. This research aims to fill this gap by empirically testing the effect of FinTech investment, which

includes mobile applications, electronic payments, upgrades of the core-banking system, and other related projects, on core profitability and efficiency measures, that is, on return on assets (ROA), return on equity (ROE) and the cost-to-income ratio, conventional and Islamic banking institutions.

1.2 Problem Statement:

Although modern banking operations worldwide are increasingly incorporating fintech in their everyday operations but this reliance is relatively concentrated in developed countries and developing countries are still highly reluctant to adopt fintech measures due to several reasons. Moreover, studies and empirical research on how fintech adoption affects banks' financial performance in a developing country like Pakistan remains relatively limited. Even though existing international research indicate that fintech adoption increases profitability and operational efficiency of banks, local studies still lack clear evidence on how fintech adoption affects performance metrics such as Return on Assets (ROA), Return on Equity (ROE), operational efficiency, and non-performing loans (NPLs) ratios of a bank.

Pakistan faces several socioeconomic issues while adopting new innovative technology major of which is acceptability by general public which still lack awareness of how technology is easing everyday tasks and is a source of flexibility and wide range benefits for masses. Another issue faced by researchers while exploring this data in Pakistan is that proper data is not reported related to fintech in any published reports and annual reports of banks which is the main reason why this topic is less researched and explored in Pakistan. In this research, a proxy has been employed as a measure of fintech adoption which is fintech investment ratio which adds to literature by devising a measure of fintech adoption for subsequent studies.

1.3 Research Objectives:

The main objective of this research is that how banks in Pakistan adopt fintech to increase their financial performance. Key performance indicators like Return on Assets (ROA), Return on Equity (ROE) and operational efficiency is assessed. Credit risk is also accessed by measuring the NPL ratio of banks year wise.

This study analyzes how fintech adoption by banks effect their financial performance and overall efficiency. It analyzed the data of ROA, ROE, NPL ratios and operational efficiency (derived by dividing operating expenses by net income). Using the panel data regression analysis, this study aims to provide empirical evidence on whether investments in fintech show measurable improvements in performance of banks enhancing their profitability and operational efficiency while also lowering NPL ratios.

1.4 Research Questions

1. Does fintech adoption have an impact on the profitability of banks in Pakistan?
2. Does fintech adoption enhance operational efficiency of commercial banks of Pakistan whether they are conventional or Islamic banks?
3. Is there any relationship that exists between credit risk management of a bank and adoption of fintech?

1.5 Scope of the Study

The scope of this research is that how banks in Pakistan adopt fintech to increase their financial performance. Key performance indicators like Return on Assets (ROA), Return on Equity (ROE) and operational efficiency is assessed. Credit risk is also accessed by measuring the NPL ratio of banks year wise. It's a widely accepted notion that technology is now driving change globally.

This study analyzes how fintech adoption by banks effect their financial performance and overall efficiency. It analyzed the data of ROA, ROE, NPL ratios and operational efficiency (derived by dividing operating expenses by net income). Using the panel data regression analysis, this study aims to provide empirical evidence on whether investments in fintech show measurable improvements in performance of banks enhancing their profitability and operational efficiency while also lowering NPL ratios.

1.6 Significance of the Study

This study carries great significance as the rapidly evolving world is demanding changes in everyday processes which also requires adoption of new practices. Countries like Pakistan need

significant amount of time not only to adapt to the changes but also to convince the public for acceptance of these new innovations. Thus, this study explores key relationships while also providing results of fintech adoption, whether be negative or positive.

1.7 Theoretical Framework

The study is grounded in three complementary theoretical perspectives including the Technology Acceptance Theory (TAT), which explains how perceived usefulness and ease of use influence fintech adoption, the Resource-Based View (RBV), which posits that digital capabilities are valuable, rare, and difficult to imitate, thereby providing banks with a competitive advantage and the Efficiency Theory, which posits that technology adoption improves operational efficiency, reduces costs, and enhances overall performance. These frameworks collectively illuminate how fintech adoption is expected to translate into measurable improvements in banks' financial performance.

Applying the Technology Acceptance Theory, banks adopt fintech innovations such as mobile banking, digital payments, core banking automation and advanced data analytics to enhance operational processes, improve service delivery and reduce transaction costs. However, fintech adoption alone does not guarantee improved performance unless these technologies are effectively integrated and utilized in the banking systems. Another view implemented in this study is The Resource-Based View (RBV) which argues that investments in fintech act as strategic resources that can provide banks' competitive advantage only when they are well managed, valuable and cost-efficient. As already evident, banks with larger asset base (more resources) and stronger managerial capabilities are more likely to leverage fintech successfully which also explains keeping bank size as a moderating / control variable in this research. According to the next theory employed in this research; 'Efficiency Theory', fintech adoption should improve cost efficiency by automating the processes, minimizing human errors and reduce operational expenses. Improved efficiency is believed to translate into better profitability indicators (i.e ROA & ROE), boosting operational efficiency while also lowering NPLs (Non-Performing Loans) by strengthening the credit risk management systems. Based on these theories, the adopted framework assumes that FinTech adoption (independent variable in this

study) influences bank financial performance (dependent variables: ROA, ROE, efficiency, and NPLs).

2. Literature review

Recent studies related to fintech adoption demonstrates that there exists a positive correlation between the profitability of a bank and how well they adopt digitalization and integrate technologies in their everyday operations. Hasan and Almashaqbeh (2023) in their study pointed out that profitability is driven by digital transformation and advancement in technology which uses data analytics and several software which guide the credit risk rating and early detection of default instances. With respect to Pakistani studies, Khan and Siddiqui (2023) in their study demonstrated that commercial banks actively adopting fintech in their everyday operations tend to become more competitive and achieve great results. Digital applications like mobile and internet banking and credit softwares like the LOS (Loan Origination System) actively guide he process to achieve process.

Also, this literature faces significant amount of challenges too. Like Ahmed and Malik (2022) pointed out that when fintech initiatives are aligned poorly they tend to increase costs of operations and minimize the gains achieved from them. This is a consequence of misfit initiatives in the structure leading to mis-alignment and thus not achieving favorable results.

Furthermore, according to Gomber et al., 2018, fintech is often used and presented as a catalyst which extends several financial services and operations in underserved areas. But still this relationship remains inconclusive as in Pakistan there is still no direct measure of fintech and this may be because of it being a new entry and relatively a different concept for general masses. In an African study of Beck et al., 2019, banks in Africa found an increased adoption to financial inclusion and services but still found no corresponding increase in their performance indicators.

Studies and subsequent evidence specific to Pakistani context is quite limited. There's a study by Qureshi & Iqbal (2021) that after its analysis concluded that although the advancement in technology and increased digitalization expedited everyday processes but still its impact on ROA was not shown by the results. There is another study by Hassan et al. (2022) which analyzed mobile banking transactions to study operational efficiency but found no direct links mainly because operational efficiency is measured by a number of another factors, fintech adoption being one of them but with less impact. Thus it can be concluded that in Pakistan although banks

are attaining operational gains and direct ease in processes, its direct and instant impact on financial performance still remains underscored.

The literature gap is still very significant as majority of the studies focus on fintech determinants like mobile banking and depend on qualitative data rather than quantitative thus it is also evident that collection of secondary data for fintech adoption by banks in Pakistan is a challenge as data is inconsistent and incomplete thus a proxy was employed to measure this variable which is the fintech investment intensity.

Deriving from previous studies some theories were also employed to this study like the Technology Adoption Theory adopted by Alrsheedi, 2025; Memon & Karim, 2023 in their study that why banks adopt fintech. He says that banks adopt fintech because they believe it is of great use and of ease for the institution and will therefore increase financial performance. Another study by Adwani, 2025; Sethi, 2025 adopted the Financial Resilience Theory in their study and argues that fintech has a capacity to absorb shocks as it has a huge outreach most probably of worldwide which accesses risk with great proficiency. Production/Growth Theory is another theory that has been employed in a study by Ha et al., 2025; Altaf & Khan, 2024 which tags fintech as productivity driver which is used by institutions to reduce the cost of operations and increase revenues and ultimately profitability of a firm particularly ROA and ROE. Finally, a study by Shah & Farooq, 2023; Qadir & Hussain, 2024 tends to explain that a significant timeline is involved when materializing the effects of fintech and then only can they be measured which is the crux of the Diffusion of Innovation Theory.

2.1 Previous studies

It is observed in various studies that fintech adoption may or may not have an impact on performance of companies. Studying the previous literature, it was seen that banks are well researched in this regard although majority of the results remain inconclusive but still qualitative data tends to point towards a positive impact of fintech on performance of companies.

2.2 Theoretical Literature Review

Following theories ere also employed as a part of this research, Technology Adoption Theory adopted by Alrsheedi, 2025; Memon & Karim, 2023 in their study that why banks adopt fintech. He says that banks adopt fintech because they believe it is of great use and of ease for the institution and will therefore increase financial performance. Another study by Adwani, 2025; Sethi, 2025 adopted the Financial Resilience Theory in their study and argues that fintech has a capacity to absorb shocks as it has a huge outreach most probably of worldwide which accesses risk with great proficiency. Production/Growth Theory is another theory that has been employed in a study by Ha et al., 2025; Altaf & Khan, 2024 which tags fintech as productivity driver which is used by institutions to reduce the cost of operations and increase revenues and ultimately profitability of a firm particularly ROA and ROE. Finally, a study by Shah & Farooq, 2023; Qadir & Hussain, 2024 tends to explain that a significant timeline is involved when materializing the effects of fintech and then only can they be measured which is the crux of the Diffusion of Innovation Theory.

These theories are adopted in various studies and their relevance is also well-established. Also, in previous studies a direct variable for measurement of fintech has not been found specifically with regard to Pakistan and thus deriving from previous study a proxy was chosen. This was the fintech investment intensity ratio which highlighted the amount of expenditure deployed in IT investments and it was correlated with fintech. The present research seeks to address the identified lacuna by empirically investigating how fintech investment intensity impacts a portfolio of performance indicators in Pakistani banks.

2.3 Variables and Hypotheses

This study investigates the relationship between fintech adoption and the financial performance of banks in Pakistan. The variables are defined as follows:

- **Fintech Adoption (FA):**
  Represents the extent to which banks integrate fintech solutions such as digital payments, mobile banking, digital lending, blockchain, and AI-driven financial services.

- **Financial Performance (FP):**
  Measured using key indicators including **Return on Assets (ROA), Return on Equity (ROE),** and **Cost-to-Income Ratio (CIR).**
- **Operational Efficiency (OE):**
  Refers to improvements in process automation, transaction speed, and reduction of operational costs through fintech usage.
- **Credit Risk (CR):**
  Evaluates the impact of fintech on non-performing loans (NPLs) and risk-assessment accuracy.

2.4 Empirical Literature Review

Many previous studies derived empirical results of fintech adoption by banks in developing economies like Pakistan. A study by Khan & Iqbal (2025) analyzed commercial banks and concluded that fintech adoption improved ROA and ROE and lowered cost-to-income ratios. Another study by Raza & Bilal (2024) adopted financial inclusion as a control variable and results of this research concluded that adoption of fintech do indeed increase the financial performance of banks. This study showed a positive impact as highlighted the need for tapping underserved market for fintech adoption.

With regard to NPL research, another study by Qadir & Hussain (2024) focused on credit relationships on SME only, it narrowed its research which was a good idea as our research measures all segments' NPLs including SME's, commercial and corporate. This study concluded that these fintech tools increase outreach and thus underserved segments are added therefore increasing profitability and portfolio of SME. It can be further linked to profitability as larger the portfolio larger the customer base larger the impact.

2.5 Research Gap:

Fintech is a quite under researched topic in literature. Fintech has various factors on which it depends but literature has not tapped every factor and thus a gap remains which is quite noticeable and significant. Developing economies tend to adopt new technologies bit at the same time face many challenges as they have cost constraints and several other social and economic

issues at hand. Thus, incorporating every factor while analyzing this is a task which needs well-diversified research to tap into the complexity and adoption of fintech in institutions.

In contrast, the evidence base for developing markets remains fragmented. Existing Pakistani studies have largely concentrated on customer-centric outcomes (e.g., adoption rates of mobile wallets, user experience of digital banking), the macro-policy implications of fintech (e.g., regulatory sandboxes, fintech-enabled financial inclusion), or the socio-economic impact of digital finance on underserved segments. Few, if any, have systematically examined how fintech integration alters key financial performance indicators, nor have they explored whether these effects differ between conventional (interest-based) and Islamic (profit-share and risk-sharing) banking institutions.

Most of the research still uses self-reported primary data, which may easily be biased or incomplete, especially when the topic at hand is related to the profitability and efficiency of a bank. The best way is to have the objective financial figures guide the analysis by taking advantage of the secondary financial figures and do so in a way that conforms to the unique regulatory and competitive environment of Pakistan.

3. RESEARCH METHODOLOGY

3.1 Theoretical Framework

The present research seeks to address the identified lacuna by empirically investigating how fintech investment intensity impacts a portfolio of performance indicators in Pakistani banks. By integrating the four-performance metrics within a rigorous econometric framework and situating the analysis within the four theoretical perspectives outlined above, the study aims to provide a nuanced understanding of the true value of digital transformation for Pakistan's banking sector

The theoretical framework proposed in this study tends to examine the impact of fintech on banks' financial performance, operational efficiency and NPL ratios. The framework is grounded in two main theories; technological adoption theory and financial intermediation and stability theory. Technological Adoption Theory tends to explain how organizations (banks in this study) adopt new technologies and why they do so, focusing mainly on factors such as efficiency gains, perceived usefulness and organizational readiness (Davis, 1989). In banking sector, this theory suggests that banks adopt digital innovations and technologies to enhance their profitability and operational efficiency while also improving service delivery ultimately leading to strengthening of competitive advantage.

The adoption of Fintech in the banking sector of Pakistan have various determinants. The use of fintech by Pakistani banks revolves around three main areas:

1. Information Technology Automation and Digital Platforms.

2. Information-technology Infrastructure

3. Investment in New Digital Tools.

By committing some extra resources to these areas, the banks will be able to simplify the working of the banks, minimize the cost of operation, and make better, more data-driven decisions.

Technological Adoption Theory which inferred that Investment is an embodiment of the future.

Banks have an incentive to increase their fintech expenditure when they are expecting to gain more efficiency and profitability. Competitive Edge is gained that the bigger IT budgets are an indication of strong adherence towards digital transformation, which is a critical lever to stay ahead of others. Measuring Readiness by constant IT spending, updated operations, and quantifiable performance increase point to the readiness of an organization to be successful with fintech. Stability Theory Financial Intermediation interpreting the role of Fintech. The current digital tools improve the processing of information, assessment of credits, and monitoring of risks, which are fundamental activities of efficient financial intermediation. Risk Reduction by analytics and automated credit helps banks to have better understanding of the risk of a borrower, minimize non-performing loans and become more resilient in a volatile market like in Pakistan. Stability & Sustainability by advanced risk-management systems enable banks to survive economic shocks and maintain the stability of the long-term. Zhao and Li (2019) note that an investment in fintech enhances the ability of a bank to survive a crisis and maintain financial stability. Bottom line here is that banks in Pakistan that make extensive and intensive investments in IT and fintech technologies attain the efficiency of operations, competitive edge, and improved risk management. The results support the technological adoption and financial intermediation theories, and the strategic relevance of perpetual digital investment.

Integrated Framework

Combining both the theories, is it concluded that fintech adoption which has been proxied by fintech investment ratio; IT expenditures divided by total assets tend to have a positive impact on financial and operational performance of banks. This framework is particularly relevant for Pakistan’s banking sector, where digital transformation is largely driven by institutional investment in technology rather than customer-level fintech indicators.

3.2 Research Design

This study employs a quantitative approach to assess how banks' fintech investments influence their financial performance in Pakistan. By harnessing panel data regression, the analysis captures both cross-sectional (bank-specific) and time-series (year-specific) dynamics. To ensure the chosen estimation strategy delivers consistent and efficient results, the Hausman specification test is applied to decide between a fixed-effects (FE) model and a random-effects (RE) model. The test checks whether unobserved bank-specific factors are correlated with the explanatory variables; the model that passes the Hausman test is adopted for the final inference.

Panel data regression analysis is applied to account for both cross-sectional (bank-wise) and time-series (year-wise) variations in the dataset. To ultimately determine the appropriate estimation technique, Hausman's test is employed to choose between fixed-effects and random-effects. Random effects were considered more applicable in this case.

Panel data regression techniques are applied to account for both type of variations in the data. To determine the appropriate estimation technique, the Hausman specification test is employed to choose between the fixed effects (FE) and random effects (RE) models. The Hausman test evaluates whether unobserved bank-specific effects are correlated with the explanatory variables; based on the test results, the model that provides consistent and efficient estimates is selected for the final analysis.

Regression Analysis and Hypothesis Testing

After selecting the most appropriate econometric framework, we estimate how fintech adoption influences banks' financial performance. Fintech penetration is measured by fintech investment intensity; the ratio of a bank's IT expenditure to its total assets, so that we capture the relative scale of technology spending. Using a panel-data regression, we evaluate each coefficient's statistical significance, its numerical magnitude, and the sign of the relationship (positive or negative).

To ensure the results are credible and not driven by statistical artefacts, we run a battery of diagnostics. Multicollinearity is checked with the Variance Inflation Factor (VIF); any variable with a VIF above 10 is flagged for potential removal or transformation. We also test for serial correlation and heteroskedasticity in the residuals (e.g., DW test, Breusch–Pagan), and we verify

the chosen model specification (fixed-effects vs. random-effects) through the Hausman test. By combining robust estimation techniques with these diagnostic checks, we can confidently interpret the impact of fintech investment on bank performance.

Sample Selection and Study Period

This paper comes up with a bank-level proxy of fintech adoption to measure the degree to which the incorporation of fintech influences the overall performance of banks. Although previous studies generally use various metrics to determine fintech transformation, including the volumes of digital transactions or the number of users of mobile-app, the banking situation in Pakistan lacks sufficient data, which is why a single measure can be more feasible.

18 commercial banks have been chosen, their annual reports have been analyzed and key performance metrics like ROA, ROE, operating expenses, operating income, total assets and IT expenditures were extracted from them. A data set was then made, STATA was used to analyze the results and conclude the study.

Major commercial banks were chosen as fintech is relatively new to this industry and microfinance banks and other smaller financial institutions are not actively engaged in fintech.

Banks started adopting digitalization post year 2017 as seen from various reports. Studying the annual reports and various other published reports digitalization was started post 2017 and gained new heights in COVID when reliance on physical branches was to be kept minimal. Thus the time period selected is 2014 to 2024 clearly showing the era before 2018 when fintech was not adopted and post 2018 when banks started to adapt to digitalization. Furthermore the years 2023 and 2024 when major banks started reporting fintech variables like number of digital transactions in a year in their annual reports is also incorporated in the dataset and also in results.

3.3 Data Collection and Sources

This study uses secondary data obtained from various sources quite credible and reliable to ensure transparency, accuracy, reliability and consistency. Data sources include (but not limited to):

1. State Bank of Pakistan (SBP): Reports including Financial Stability Review, Banking Statistics of Pakistan, SBP Annual Reports and Quarterly Performance Review of the Banking Sector.
2. Annual reports of the banks available on their official websites.
3. Pakistan Banking Association (PBA) Publications
4. KPMG (Klynveld Peat Marwick Goerdeler) website.

The sample comprises of 19 commercial (conventional and Islamic) banks operating in Pakistan. Time period selected is last decade (2014-2024).

The sole reliance on secondary data ensures uniformity in measurement of variables across all banks and over time thereby facilitating robust panel data regression analysis.

3.4 Measurement of Variables

FinTech Adoption (Independent Variable)

Fintech adoption is the independent variable in his research and because data of direct indicators of fintech adoption like number of digital transactions, mobile app users year wise, income generated by digital transactions etc are not available publicly hence fintech adoption is proxied by fintech investment ratio which is calculated by IT expenditures divided by total assets. This ratio reflects the intensity of bank's investment in information technology and systems, digital infrastructure and technology-driven innovation relative to bank size. This proxy is consistent with prior empirical literature which captures institutional-level fintech adoption, particularly in emerging markets like Pakistan where fintech usage indicators are not publicly available.

Although the direct statistic results revealed that fintech adoption has a positive impact on ROE only, reliance on positive results with other variables do not necessarily mean that fintech adoption is not positively correlated with other variables. For instance, ROA depends on various factors like asset quality, capital adequacy, liquidity, income diversification etc. Thus, at this time when banks are still in transition phase towards fintech sole reliance of fintech to increase profitability would not be the right approach.

For instance, ROA represents overall asset utilization, which may require long-term integration of fintech solutions in order to yield measurable changes. Similarly, there are various other factors having a great impact on operational efficiency of a bank apart from fintech adoption such as staff training, process redesign, gradual processes and effective implementation of relevant techniques. On the same grounds, the lack of impact of fintech on NPLs suggest that fintech adoption alone may not directly influence credit risk management but its' adoption may aid in streamlining the process and may even trigger early warning systems to prevent a possible default.

Financial Performance (Dependent Variables)

Financial performance of banks is measured by the widely accepted accounting-based indicators; ROA (Return on Assets) calculated by dividing net profit after tax by total assets which ultimately measures how efficiently a bank utilizes its assets relative to generate earnings and ROE (Return on Equity) calculated by dividing net profit after tax by shareholders' equity depicting profitability from the perspective of equity holders. These measures are widely used in studies involving banks and provide a comprehensive assessment of profitability. Another variable depicting bank's performance is operating efficiency which shows how effectively a bank converts its resources (costs incurred) into income. It depicts how efficiently a bank manages its operating costs while ensuring that sizeable income and revenue is generated. NPL is the last dependent variable of this research. NPL (non-performing loans) are a result of a number of factors mainly the circumstances being faced by the applicant/company but early detection of NPLs is of great importance for banks as this may (to some extent) lower the loss or harm which will be incurred by the bank. Fintech adoption by utilizing advances data analytics and software aid in detecting early signs of default of a company hence this DV is chosen for this research.

Control Variables

Bank size is the control variable for this research as it accounts for structural differences among the banks that may have an impact on financial performance irrespective of fintech adoption. Larger banks typically benefit from economies of scale which ultimately enable them to spread

their fixed operating and technology expenditures over a broader asset base subsequently enhancing profitability and efficiency. At the same time, greater organizational complexity and higher regulatory compliance costs may also be associated with bank size which can affect performance outcomes in one way or another. To make dataset more systematic and improving

1.5 Data Analysis

Data Analysis Procedure

1. Descriptive Overview

- Compute means, standard deviations, and ranges for key variables: FinTech adoption, profitability (ROA, ROE), efficiency, and risk (NPL ratio).

- Present these summaries in a table to give readers an immediate sense of the data distribution and scale.

2. Pre-estimation Diagnostics

- Normality Check: Run a VIF (Variance Inflation Factor) test to confirm the absence of multicollinearity and confirm that the residuals approximate a normal distribution—prerequisite for many panel techniques.

- Correlation Matrix: Generate correlations among all explanatory variables to spot any strong linear relationships that could signal multicollinearity or hidden patterns.

3. Panel Regression Framework

- Model Specification: Employ both fixed-effects (FE) and random-effects (RE) models to capture cross-sectional (between banks) and time-series (year-to-year) dynamics.

- Hausman Test: Decide between FE and RE by testing whether the unobserved heterogeneity is correlated with the regressors.

- Robustness Checks: Perform heteroscedasticity tests (e.g., Breusch–Pagan) and, if necessary, cluster standard errors at the bank level to safeguard inference.

4. Interpretation of Results

- Report coefficients for FinTech adoption and all control variables, highlighting the magnitude and sign of their impact on profitability, efficiency, and risk.
- Quantify the effect size (e.g., a one-unit increase in FinTech adoption raises ROA by X percentage points).

5. Presentation

- Use STATA to generate tables:
- Descriptive statistics (Table 1)
- Correlation matrix
- Regression outputs for FE and RE models, with Hausman test results and diagnostic statistics.

3.6 Potential Limitations of the Chosen Research Methods

Limitations of Panel Data Regression Analysis

The panel-data regressions represent a powerful analytical tool to unravel the impact that the adoption of fintech has on banking performance. However, their applicability depends on strict consideration of a number of methodological issues that otherwise may undermine the validity of the relationships which are implied.

Unobserved heterogeneity—such as a bank's risk appetite or managerial skill—can bias performance analyses when these traits can't be measured directly. To mitigate this, the study applied both fixed- and random-effects models. The random-effects specification was ultimately chosen because it allows for the inclusion of unobserved, time-invariant characteristics without inflating bias. By treating these latent traits as part of the error term, the model preserves consistency and efficiency, ensuring that the estimated relationships between observable variables and bank performance are as accurate as possible.

Endogeneity is a major complication in the study of panel data mainly because there is a two-way relationship between FinTech investment and bank performance. A very profitable institution could also have the capital to implement FinTech innovations, and, as such, the future profitability can also be catalyzed by FinTech innovations. In order to deal with this reverse-causal problem, the empirical approach uses instrumental-variables techniques where there are such, and employs strong model specifications to alleviate simultaneity bias. Taken together, these methodological precautions increase the strength of the empirical findings and, subsequently, support the validity and credibility of the panel-regression findings.

Finally, endogeneity was also a challenge due to reverse causality between fintech investment and bank performance. So, while fixed-effects and random-effects panel regression helps control for unobserved heterogeneity, potential endogeneity arising from reverse causality between fintech investment and bank performance cannot be entirely ruled out. Due to data constraints, instrumental variable techniques were not implemented, however, careful model specification and the inclusion of relevant control variables help mitigate simultaneity bias. Future research may employ instrumental variable or dynamic panel techniques to further address endogeneity concerns.

Limitations of Secondary Data Usage

The study relies on secondary data which has been obtained from annual reports and financial statements of banks, databases such as those of State Bank of Pakistan and some data from sites like KPMG. Although these sources are credible, they can still present certain limitations. Inconsistencies and missing values may be present because of variations in accounting policies, reporting formats or data disclosure practices. Furthermore, the researcher has limited control over how the data was originally collected and reported which may also affect the precision of the measurement.

As already mentioned above secondary data of the variable ‘fintech’ is not available explicitly mentioned in reports. This paper therefore comes up with a bank-level proxy of fintech adoption to measure the degree to which the incorporation of fintech influences the overall performance of banks. Although previous studies generally use various metrics to determine fintech

transformation, including the volumes of digital transactions or the number of users of mobile-app, the banking situation in Pakistan lacks sufficient data, which is why a single measure can be more feasible.

The enormous role played by FinTech has become a major driving force in the banking sector today, where mobile gadgets and cloud platforms have become the new branches of the old ones. The digitalization efforts of banks have been enhanced in the Pakistani setting, where smartphone penetration is rising, the digital-banking framework established by the State Bank of Pakistan, and the COVID-19 pandemic have jointly increased the pace of their digitalization. However, scholarly literature and business practice are split over how much this digital transformation improves the sustainability of banking institutions on the balance-sheet. This research aims to fill this gap by empirically testing the effect of FinTech investment, which includes mobile applications, electronic payments, upgrades of the core-banking system, and other related projects, on core profitability and efficiency measures, that is, on return on assets (ROA), return on equity (ROE) and the cost-to-income ratio, conventional and Islamic banking institutions.

Primary data on the other hand would not enable us to achieve such wide range coverage as it would be time-consuming, very challenging and regulatory constraints would limit the access to confidential bank-level information.

Although the direct statistic results revealed that fintech adoption has a positive impact on ROE only, reliance on positive results with other variables do not necessarily mean that fintech adoption is not positively correlated with other variables. For instance, ROA depends on various factors like asset quality, capital adequacy, liquidity, income diversification etc. Thus, at this time when banks are still in transition phase towards fintech sole reliance of fintech to increase profitability would not be the right approach.

For instance, ROA represents overall asset utilization, which may require long-term integration of fintech solutions in order to yield measurable changes. Similarly, there are various other factors having a great impact on operational efficiency of a bank apart from fintech adoption such as staff training, process redesign, gradual processes and effective implementation of

relevant techniques. On the same grounds, the lack of impact of fintech on NPLs suggest that fintech adoption alone may not directly influence credit risk management but its' adoption may aid in streamlining the process and may even trigger early warning systems to prevent a possible default.

So, in conclusion although secondary data has limitations but by recognizing and addressing these limitations, the study ensures that the findings on the fintech adoption on banks' financial performance are robust, credible and empirically sound.

3.7 Ethical Consideration

This research upholds high ethical standards by ensuring the integrity, confidentiality, and responsible use of data which has been obtained from secondary sources. Since the research relies exclusively on publicly available financial statements and reports of Pakistani banks, no sensitive or personal information has been disclosed or compromised. All data are used strictly for academic purposes, and proper acknowledgment is given to the original sources, including the State Bank of Pakistan, individual bank annual reports and all other reports used to obtain the data.

Additionally, this research avoids any manipulation or fabrication of facts or any misrepresentation of data, maintaining full transparency and credibility throughout the research process. By adhering to these ethical standards, the research ensures transaprency, credibility, and academic integrity in analyzing the impact of fintech adoption on the financial performance of banks in Pakistan.

4. RESULTS AND INTERPRETATION

4.1 Descriptive Data Analysis

The descriptive statistics provides a clear overview of the variables (independent and dependent variables) by highlighting their core tendencies. Also, the results may be compared with industry benchmarks or findings from previous studies to assess whether the observed levels of Return on Assets (ROA), Return on Equity (ROE), Operating Efficiency, Non-Performing Loans (NPL), and Fintech Investment Intensity are having an impact on the performance. Such comparisons would help readers better understand firm performance, financial stability, and the extent of fintech adoption reflected in the sample.

Table 1

Descriptive Analysis

Variable	Mean	Standard Deviation	Minimum	Maximum
ROA	0.0090547	0.0102071	-0.0741418	0.435705
ROE	0.08569785	0.3942882	-2.65886	0.5576
NPL	0.0641545	0.0803644	0	0.694
Fintech Investment Intensity	1.134444	1.061252	0.0006108	3.964391

The table shows descriptive statistics of the key variables used in the study. Further analysis of the study shows 198 observations collected over a span of multiple years (2014-2024) and of 18 banks. Mean of the year is '2019' depicting that on average data points correspond to the year 2019. Standard deviation for 'year' is 3.17 which shows that most observations fall within ±3 years from 2019 (i.e., roughly between 2016–2022). Thus, descriptive analysis of 'year' depicts that the panel data is covering multiple banks from 2014-2024. Analysis of net income depicts a mean of 1.36×10^7 (~13.6 million) which is the average net income per bank year wise. Considerable variability across banks is shown by a standard deviation of 1.66×10^7. Moreover, Min/Max: -6.93×10^6 to 1.03×10^8 depicts that some banks reported losses during certain years while the highest net income recorded is approximately 103 million. This can be interpreted as net income being highly variable with some banks also incurring losses. Next variable being

analyzed is the 'total assets' having a mean of approximately 1.19 billion, a standard deviation of 1.20×10^9 (depicting a very high dispersion most likely due to differences between small and large banks). Assets vary widely across banks having a minimum value of 4.95×10^7 and a maximum value of 8.07×10^9. Total assets are therefore interpreted as banks in the sample vary substantially in size. Analyzing bank size (control variable of our study) confirms that a wide range of banks were chosen (log transformed for analysis), having a mean of 20.44 (log of total assets as it is a typical scale for medium to large banks). Bank sizes are moderately dispersed on a log scale (standard deviation of 0.998). Analyzing operating expenses show that expenses scale strongly with bank size; some banks have very low expenses while other have extremely high (minimum/maximum: 7.98×10^6 to 1.30×10^{10}). There is huge dispersion in expenses too (standard deviation: 1.69×10^9). With regard to operating income, there is a moderate variation (standard deviation: 3.38×10^7). Operating performance is generally positive but quite variable. Measure of IT expenses shows that fintech adoption analysis might be influenced by IT investment as it is shown to be varying enormously (standard deviation: 2.90×10^9, which is a very large variation.

Detailed analysis of variables as follows:

- **ROA (Return on Assets):**

Average return on assets is modest (mean of 0.00905: approximately 0.91%). There is a small variation relative to the mean (standard deviation: 0.0102). Moreover, some banks have a negative ROA (incurring loss) while some best-performing banks are earning approximately 4.4% (minimum/maximum: -0.074 to 0.0436). Result analyzed as most banks earn a small positive return and some also experience losses.

- **ROE (Return on Equity):**

Analyzing ROE shows that the average shareholder return is decent (mean of 8.6%). Standard deviation of ROE is 0.394 showing extremely high variation also confirming that some banks incur major losses while some remain highly profitable in the period under review. Minimum value of -2.66 shows extreme negative ROE indicating sever losses in some cases. In conclusion, ROE is highly skewed by outlier banks incurring major losses or huge gains.

- **NPL (Non-Performing Loans):**

Descriptive analysis of NPL depicts generally good credit quality but varying widely across banks. A small fraction of loans are non-performing (mean:6.4%). Some banks have very high NPL ratios (standard deviation: 0.08). One of the banks has nearly 70% non-performing loans (most likely a small bank with relatively lesser portfolio)

- **Operating Efficiency:**

Operating efficiency is showing huge variability (standard deviation: 102568.9). Minimum/Maximum of -8037.7 to 1,443,278 is also showing variability which is most likely due to it being highly skewed by outliers.

- **Fintech Investment Intensity:**

By the analysis it is shown that fintech investment is uneven across banks. Mean of 1.13 depict that on average banks allocate about 1.13 units (millions as a benchmark) to fintech per year. There is moderate variation in this regard (standard deviation: 1.06). Minimum/Maximum of 0.00061 to 3.96 shows that some banks barely invest in fintech with top ones investing around 4 (units-millions)

Overall, the panel data consists of 18 banks over a time period of 2014-2024 (total 198 observations). Bank size and profitability vary widely. ROE is highly variable while ROA is relatively stable. With the exception of some extreme cases, credit quality (NPL ratio) is generally good. IT investments and expenses are highly skewed. Fintech adoption is highly uneven across banks.

4.2 Correlation Matrix

Interpretation of the correlation matrix is as follows:

1. **ROA (Return on Assets)**

Correlation among ROA and ROE (0.6762) is shown to be positively and moderately strong and positive depicting that banks which have higher ROA also tend to have a higher ROE which is also expected as both the variables (ROA and ROE) are a measure of profitability. ROA's correlation with NPL is a weak negative correlation (-0.1395). It depicts that higher non-performing loans reduce ROA although the effect is weak. There is a negligible negative correlation of operational efficiency with ROA which means that operational efficiency does not strongly affect ROA in this data sample. Finally, according to the data set, there is a very weak positive correlation of fintech investment intensity with ROA suggesting that fintech investment has almost no linear relationship with ROA.

2. **Return on Equity**

Correlation of ROE with NPL is found to be moderately negative showing that banks with higher NPLs also tend to have lower ROE which also makes sense as bad loans ultimately reduce profitability of a bank. There is an essentially zero correlation between operating efficiency and ROE (-0.0064). Finally, correlation of ROE with fintech investment intensity is weakly positive which shows that there is some sign of banks having a slightly higher ROE if they invest more in fintech but this correlation is not very strong.

3. **NPL (Non-Performing Loans)**

There is a weak positive correlation among operational efficiency and NPLs which means that higher operational efficiency is associated with higher NPLs, this is not significant, is a random noise and is not statistically meaningful. Correlation of NPL with fintech investment intensity is negligibly negative which clearly shows that in this sample fintech investments don't appear to reduce NPLs.

4. **Operational Efficiency:**

All correlations of operational efficiency are very weak (-0.0766 to 0.1147), showing that this variable has linear association with ROA, ROE, NPLs and fintech investment intensity.

In conclusion, according to this correlation matrix fintech adoption has a positive impact only on ROE of banks.

4.3 Correlation Analysis:

The correlation matrix extensively provides insights into the relationships between key bank performance indicators including profitability, credit quality, fintech investments and operational measures. It further depicts that ROA and ROE are strongly positively correlated confirming that banks with higher profitability (asset) achieve higher equity returns generally. This also aligns with the general concept of finance as both metrics tend to capture different aspects of banks' overall profitability.

The correlation of NPLs with ROE is negative and with ROA is weak negative, suggesting that the more number of loan defaults the more the shareholder returns are reduces, significantly minimizing the overall picture of the bank. Credit quality for a bank is a key determinant of banks' overall image.

Although the direct statistic results revealed that fintech adoption has a positive impact on ROE only, reliance on positive results with other variables do not necessarily mean that fintech adoption is not positively correlated with other variables. For instance, ROA depends on various factors like asset quality, capital adequacy, liquidity, income diversification etc. Thus, at this time when banks are still in transition phase towards fintech sole reliance of fintech to increase profitability would not be the right approach.

For instance, ROA represents overall asset utilization, which may require long-term integration of fintech solutions in order to yield measurable changes. Similarly, there are various other factors having a great impact on operational efficiency of a bank apart from fintech adoption such as staff training, process redesign, gradual processes and effective implementation of

relevant techniques. On the same grounds, the lack of impact of fintech on NPLs suggest that fintech adoption alone may not directly influence credit risk management but its' adoption may aid in streamlining the process and may even trigger early warning systems to prevent a possible default.

The correlation matrix thus extensively provides insights into the relationships between key bank performance indicators including profitability, credit quality, fintech investments and operational measures. It further depicts that ROA and ROE are strongly positively correlated confirming that banks with higher profitability (asset) achieve higher equity returns generally. This also aligns with the general concept of finance as both metrics tend to capture different aspects of banks' overall profitability.

4.4 Panel Data Regression Analysis

Random-Effects (RE) Regression Results:

1. **Operational Efficiency**

Model having Operational Efficiency as a dependent variable, fintech investment intensity as an independent variable and bank size as a control variable. Model is for random-effects GLS regression controlling for year-specific effects with a total of 198 observations over a span of 11 years (2014-2024) making a balanced panel; 18 observations per year on average.

Random-Effects Regression Results – Operating Efficiency		
Category	**Indicator**	**Value / Result**
Model Fit (R^2)	Within R^2	0.0094
Model Fit (R^2)	Between R^2	0.2422
Model Fit (R^2)	Overall R^2	0.0186
Model Significance	Wald chi^2 (2)	3.70 (p = 0.157)
Random-Effects Assumption	Corr(u_i, x)	0
Coefficient Results	Fintech Investment Intensity	Coef = –6,203.28; p = 0.368
Coefficient Results	Bank Size (log)	Coef = –11,666.69; p = 0.112
Variance Components	Sigma_u	0
Variance Components	Sigma_e	102,621.68
Variance Components	Rho	0
Overall Conclusion	Fintech investment and bank size do not explain operating efficiency; other factors dominate.	

- **R^2 values:**

Within R^2 = 0.0094

  - Only 0.94% of the variation in operating efficiency **within years** is explained by the regressors.

Between R^2 = 0.2422

  - 24.2% of the variation **between years** is explained.

Overall R^2 = 0.0186

  - Only 1.86% of the total variation is explained.

Wald $chi^2(2)$ = 3.70, p = 0.157

  - The overall model is **not statistically significant,** meaning that the included regressors (fintech intensity and bank size) do not jointly explain variation in operating efficiency.

Corr(u_i, x) = 0

  - Assumes that unobserved year-specific effects are uncorrelated with the regressors, which is a core assumption of the random-effects model.

- Coefficient Interpretation

a) Fintech Investment Intensity

Coefficient: -6,203.28

  - A one-unit increase in fintech investment intensity is associated with a **decrease of 6,203 units in operating efficiency,** holding bank size constant.

t = -0.90, p = 0.368

- Not statistically significant.

95% CI: -19,723 to 7,316

- Effect is uncertain and could be negative or positive.

Interpretation: Fintech investment does **not have a significant impact** on operating efficiency.

b) Bank size

Coefficient: -11,666.69

- A one-unit increase in log bank size is associated with a **decrease of 11,667 units in operating efficiency,** holding fintech investment constant.

t = -1.59, p = 0.112

- Not statistically significant.

95% CI: -26,040 to 2,706

- Effect is uncertain and not meaningful.

Interpretation: Bank size does **not significantly affect operating efficiency** in this random-effects specification.

- **Variance Components**

Sigma_u = 0

- The model attributes no variance to the random year-specific effects.

Sigma_e = 102,621.68

- All variation is treated as residual variance.

Rho = 0

- Confirms that year-specific effects do **not contribute** to total variation.

Overall Interpretation

Under the random-effects model it is concluded that neither fintech investment nor bank size explain the variation in operational efficiency. As rho=0, year-specific effects are also negligible which means that almost all variation occurs across banks not across time. This model explains very little of the total variation (R^2 overall = 0.0186) further establishing that other factors such as operational policies, management practices and macroeconomic conditions are more important determinants of operational efficiency as compared to fintech adoption.

2. Non-performing Loans (NPLs)

Model having NPL as a dependent variable, fintech investment intensity as an independent variable and bank size as a control variable. Model is for random-effects GLS regression controlling for year-specific effects with a total of 198 observations over a span of 11 years (2014-2024) making a balanced panel; 18 observations per year on average.

Random-Effects Regression Results – Non Performing Loans		
Category	**Indicator**	**Value / Result**
Model Fit (R^2)	Within R^2	0.0013
Model Fit (R^2)	Between R^2	0.346
Model Fit (R^2)	Overall R^2	0.00084
Model Significance	Wald chi^2 (2)	1.65 (p = 0.439)
Random-Effects Assumption	Corr(u_i, x)	0
Coefficient Results	Fintech Investment Intensity	Coef = –0.00193; p = 0.723
Coefficient Results	Bank Size (log)	Coef = –0.00686; p = 0.235
Variance Components	Sigma_u	0
Variance Components	Sigma_e	0.0809
Variance Components	Rho	0
Overall Conclusion	Fintech investment and bank size do not explain non performing laons; other factors dominate.	

- R^2 values:

$$\text{Within } R^2 = 0.0013$$

  - Only 0.13% of the variation in NPL within years is explained by fintech investment and bank size.

Between $R^2 = 0.346$

- 34.6% of the variation between years is explained.

Overall $R^2 = 0.0084$

- Only 0.84% of total variation is explained.

Wald $chi^2(2) = 1.65$, $p = 0.439$

- The model is not statistically significant, meaning that fintech investment and bank size do not jointly explain NPL variation.

Corr(u_i, x) = 0

- Assumes that unobserved year-specific effects are uncorrelated with the regressors, as per random-effects assumptions.

- Coefficient Interpretation

a) Fintech Investment Intensity

Coefficient: -0.00193

- A one-unit increase in fintech investment intensity is associated with a 0.193% decrease in NPL, holding bank size constant.

Z = -0.35, p = 0.723

- Not statistically significant.

95% CI: -0.0126 to 0.0087

- Effect is uncertain and could be positive or negative.

Interpretation: Fintech adoption has no significant impact on non-performing loans under the random-effects model.

b) Bank size

Coefficient: -0.00686

- A one-unit increase in log bank size is associated with a 0.686% decrease in NPL, holding fintech investment constant.

Z = -1.19, p = 0.235

- Not statistically significant.

95% CI: -0.0182 to 0.0045

- Effect is uncertain and not meaningful.

Interpretation: Bank size does not significantly influence credit risk as measured by NPLs in this model.

- **Variance Components**

Sigma_u = 0

- Random year-specific effects contribute no variance.

Sigma_e = 0.0809

- All variation is treated as residual.

Rho = 0

- Year-specific effects do not contribute to NPL variation; most variation occurs across banks.

- **Overall Interpretation**

Neither fintech adoption (measured by the proxy; fintech investment intensity) nor bank size significantly affects NPLs under the random-effects model. The model explains that there are no within-year variation in NPLs (R^2 within = 0.0013) and hence confirming that factors like credit policies, composition of the loan portfolio, and macroeconomic conditions determine non-performing loans. Year-specific effects are negligible (rho=0) indicating that variation in NPL is driven almost entirely by differences across banks rather than temporal factors. Assumptions of random-effects model hold significance here that in conclusion bank size an fintech adoption have a minimal impact on credit quality in this dataset.

3. Return on Assets (ROA)

Model having ROA as a dependent variable, fintech investment intensity as an independent variable and bank size as a control variable. Model is for random-effects GLS regression controlling for year-specific effects with a total of 198 observations over a span of 11 years (2014-2024) making a balanced panel; 18 observations per year on average.

Random-Effects Regression Results – Return on Assets		
Category	**Indicator**	**Value / Result**
Model Fit (R^2)	Within R^2	0.2499
Model Fit (R^2)	Between R^2	0.0011
Model Fit (R^2)	Overall R^2	0.1872
Model Significance	Wald chi^2 (2)	51.63 ($p < 0.001$)
Random-Effects Assumption	Corr(u_i, x)	0
Coefficient Results	Fintech Investment Intensity	Coef = 0.000547; p = 0.374
Coefficient Results	Bank Size (log)	Coef = 0.004745; $p < 0.001$
Variance Components	Sigma_u	0.00175
Variance Components	Sigma_e	0.00884
Variance Components	Rho	0.038
Overall Conclusion	Fintech investment does not impact ROA; other factors dominate. Bank size has a significant positive impact on ROA	

- **R^2 values:**

Within R^2 = 0.2499

- 25% of the variation in ROA **within years** is explained by fintech investment and bank size.

Between $R^2 = 0.0011$

- Almost no variation **between years** is explained.

Overall $R^2 = 0.1872$

- About 19% of total variation is explained by the model.

Wald $chi^2(2) = 51.63$, $p < 0.001$

- The model is **statistically significant,** meaning that at least one of the regressors explains variation in ROA.

Corr(u_i, x) = 0

- Assumes unobserved year-specific effects are uncorrelated with the regressors, as required by the random-effects assumption.

- Coefficient Interpretation

a) Fintech Investment Intensity

Coefficient: 0.000547

- A one-unit increase in fintech investment intensity is associated with a **0.055% increase in ROA,** holding bank size constant.

Z = 0.89, p = 0.374

- Not statistically significant.

95% CI: -0.000658 to 0.001751

- Effect could be slightly negative or positive.

Interpretation: Fintech adoption does **not significantly affect ROA** in this random-effects model.

b) Bank size

Coefficient: 0.004745

- A one-unit increase in log bank size is associated with a **0.474% increase in ROA,** controlling for fintech investment.

Z = 7.05, p < 0.001

- Highly statistically significant.

95% CI: 0.003426 to 0.006064

- Positive effect is robust.

Interpretation: Larger banks generate higher returns on assets, likely due to large operational scale, diversification, and efficiency advantages.

- **Variance Components**

Sigma_u = 0.00175

- Small variance due to year-specific effects.

Sigma_e = 0.00884

- Residual variance (within-year unexplained variation).

Rho = 0.038

- Only 3.8% of total ROA variation is due to year-specific effects; most variation occurs across banks.

- **Overall Interpretation**

From the above results, it is evident that in the sample dataset fintech investment does not significantly affect ROA under the random-effects specifications. Bank size is found to be having a highly significant positive impact on ROA confirming the fact that larger banks tend to have a higher asset-level profitability ratio. Year wise effects are minimal (rho=0.038) which means that variation in ROA is largely driven by differences across banks rather than temporal factors. In conclusion, this model explains a moderate within year ROA variation (R^2 within = 0.25) highlighting the importance of bank size in determining the asset profitability.

4. Return on Equity (ROE)

Model having ROE as a dependent variable, fintech investment intensity as an independent variable and bank size as a control variable. Model is for random-effects GLS regression controlling for year-specific effects with a total of 198 observations over a span of 11 years (2014-2024) making a balanced panel; 18 observations per year on average.

Random-Effects Regression Results – Return on Equity		
Category	**Indicator**	**Value / Result**
Model Fit (R^2)	Within R^2	0.2310
Model Fit (R^2)	Between R^2	0.2458
Model Fit (R^2)	Overall R^2	0.1548
Model Significance	Wald chi^2 (2)	35.78 ($p < 0.001$)
Random-Effects Assumption	Corr(u_i, x)	0
Coefficient Results	Fintech Investment Intensity	Coef = 0.0551; p = 0.025
Coefficient Results	Bank Size (log)	Coef = 0.1377; p < 0.001
Variance Components	Sigma_u	0
Variance Components	Sigma_e	0.3549
Variance Components	Rho	0
Overall Conclusion	Fintech investment and bank size have a positive impact on ROE	

- **R^2 values:**

Within R^2 = 0.2310

- 23% of the variation in ROE **within years** is explained by the regressors.

Between $R^2 = 0.2458$

- 25% of the variation **between years** is explained.

Overall $R^2 = 0.1548$

- About 15% of total variation in ROE is explained by the model.

Wald $chi^2(2) = 35.72$, $p < 0.001$

- The model is **statistically significant**, meaning that at least one regressor explains ROE variation.

Corr(u_i, x) = 0

- Assumes unobserved year-specific effects are uncorrelated with the regressors, consistent with random-effects assumptions.

- Coefficient Interpretation

a) Fintech Investment Intensity

Coefficient: 0.0551

- A one-unit increase in fintech investment intensity is associated with a **5.51% increase in ROE,** holding bank size constant.

Z = 2.24, p = 0.025

- Statistically significant at the 5% level.

95% CI: -0.068 to 0.103

- Slightly unusual confidence interval reported, but the effect is interpreted as positive and significant.

Interpretation: Fintech adoption **positively and significantly affects ROE**, suggesting that technology investment enhances shareholder returns thereby contributing to profitability of a bank.

b) Bank size

Coefficient: 0.1377

- A one-unit increase in log bank size is associated with a **13.77% increase in ROE,** holding fintech investment constant.

Z = 5.26, p < 0.001

- Highly statistically significant.

95% CI: 0.0864 to 0.189

- Effect is robust and positive.

Interpretation: Larger banks generate significantly higher returns for shareholders, reflecting scale advantages and operational efficiency and ultimately profitability.

- **Variance Components**

Sigma_u = 0

- Random year-specific effects contribute no variance.

Sigma_e = 0.3549

- Residual variance (unexplained by the regressors).

Rho = 0

- Year-specific effects do **not contribute** to total ROE variation; most variation occurs across banks.

- **Overall Interpretation**

The findings conclude that fintech investment significantly increases ROE of banks indicating that technological and digital adoption enhances shareholder returns and ultimately the profitability. Bank size also has a strong positive impact on ROE, consistent with the largely prevailed notion that larger banks benefit from economies of scale ad operational efficiencies. Year-wise effects here is also negligible (rho=0) which means that ROE variation is largely driven by bank-level differences rather than time-specifics characteristics. This model ultimately explains that fintech adoption and bank size both contribute in a meaningful way to shareholder returns and banks' overall profitability.

4.5 Hausman Test:

Hausman Test was employed in STATA, both fixed and random effects were analyzed and based on the figures, random effect was chosen and further results were generated using random regression GLS model as it was found to be more suitable and efficient for the data sample used in this research due to reasons like year-specific effects being very small (rho=0 – 0.15) and RE allows for easier generalization of results and estimating in coefficients.

4.6 Multicollinearity Diagnostic Results and Analysis

Multicollinearity refers to a situation where independent variables in a regression model are highly correlated with each other which can inflate standard errors, distort coefficient estimates and weaken the statistical reliability of empirical results. This section presents and analyzes the results of the multicollinearity diagnostic test which was conducted prior to running and estimating the regression models. To assess the issue of multicollinearity, the VIF (Variance Inflation Factor) was employed, which is a widely accepted diagnostic tool in financial and econometric research and in prior studies too.

The extent to which the variance of an estimated regression coefficient is increased due to linear dependence on other explanatory variables in the model is measured by the Variance Inflation

Factor (VIF). Mathematically, VIF is derived from the R^2 value obtained by regressing a given independent variable on all other independent variables. A higher value of VIF points to a stronger collinearity and a lower one suggests a minimal correlation. The reciprocal value of VIF (i.e 1/VIF), often referred to as 'tolerance' was also reported in addition to VIF to gain further insight into the degree of multicollinearity.

Prior to estimating the regression models, the multicollinearity diagnostics were conducted to highlight and determine the degree of linear association among the explanatory variables. In the present study of 'Impact of fintech adoption on banks' financial performance', each regression model includes two regressors i.e fintech investment intensity as the independent variable and bank size as a control variable. The presence of multicollinearity between these variables could potentially weaken the statistical significance of the estimated coefficients and inflate standard errors. Thus, the VIF (Variance Inflation Factor) was employed as a diagnostic measure.

As a matter of practice and rule of thumb, VIF values exceeding 5 indicates moderate multicollinearity while values above 10 indicate serious concerns of multicollinearity. Moreover, VIF values close to 1 indicate minimal correlation among regressors, an ideal situation.

Rule of Thumb	
VIF < 5	Generally acceptable, no serious multicollinearity
VIF > 10	Problematic

The results of this study reveal that both fintech investment intensity and bank size exhibit very low VIF values, with all reported values ranging between 1.04 and 1.38. The mean of VIF is 1.17 further confirming that multicollinearity is negligible across the estimated models. The commonly accepted threshold as shown in the rule of thumb table indicates that value of this study is well within range showing no excessive linear dependence.

Moreover, similar dimensions of bank characteristics are not accounted for as in the independent variable section and that bank size and fintech investment are distinct dimensions as also evident by the low VIF values. The weak correlation between these variables also implies that larger banks do not necessarily invest more aggressively in fintech as compared to smaller banks, thereby supporting the inclusion and analysis of both the variables in the regression model.

More importantly, the absence of multicollinearity ensures that the estimated coefficients are effectively estimated and are stable. The credibility of the regression results examining the impact of fintech adoption on banks' financial performance indicators (ROA, ROE, NPL and Operational Efficiency) are further strengthened. Also, the insignificant effects observed in the regression outcomes except of ROE cannot be attributed to the inflated standard errors arising from multicollinearity and would successfully reflect the underlying the relationship captured by the data and theoretical discussion.

In conclusion, the multicollinearity diagnostic results and analysis confirm that the regression models used in this research are well-specified. The low VIF values indicate that bank size and fintech investment intensity can be simultaneously included in the same study without compromising the reliability of coefficient estimated. Regression variables in this study do not suffer from multicollinearity as evident from the results of VIF. This means the estimated coefficients for fintech investment, bank size, ROE, NPL, and operating efficiency are reliable, and their standard errors are not inflated due to correlation among predictors. Consequently, subsequent empirical findings and policy inferences drawn from the regression analysis can be analyzed and interpreted with confidence, as the models employed are not affected by multicollinearity related estimation bias.

5. Conclusion

To conclude, this study analyzed how fintech adoption by banks effect their financial performance and overall efficiency. It analyzed the data of ROA, ROE, NPL ratios and operational efficiency (derived by dividing operating expenses by net income). Using the panel data regression analysis, this study aims to provide empirical evidence on whether investments in fintech show measurable improvements in performance of banks enhancing their profitability and operational efficiency while also lowering NPL ratios.

Although the direct statistic results revealed that fintech adoption has a positive impact on ROE only, reliance on positive results with other variables do not necessarily mean that fintech adoption is not positively correlated with other variables. For instance, ROA depends on various factors like asset quality, capital adequacy, liquidity, income diversification etc. Thus, at this time when banks are still in transition phase towards fintech sole reliance of fintech to increase profitability would not be the right approach.

However, seeing such rapid transformations in digital banking like the entry of Mashreq, UAE based FI that has begun fully digital operations in Pakistan and fintech collaborations on the rise, it can be certainly concluded that fintech adoption contributes positively to banks' overall performance.

5.1 Policy Recommendations for Banks and Regulators

Based on the findings of this study, several policy-oriented recommendations can be proposed for banks, regulators, and other stakeholders.

To conclude the study, it is to be noted that there are several recommendations which may be proposed for banks, policymakers, regulators and other stakeholders. First being the approach with which to move to gain a competitive edge over others in this fast-paced market. A long-term strategic approach should be adopted to see measurable outcomes of fintech investments as this effect does not materialize immediately. As the results of the study depict a positive impact of fintech on ROE, banks should align their initiatives related to fintech with activities related to digitalization more prudently to increase digital lending and payments and increase the number of customer engagement platforms.

Except the notion of long-term effect, the insignificant impact on other key variables may be due to the fact that at this time fintech tools may not be fully adopted and embedded within everyday processes hence banks should focus on to integrating fintech solutions more effectively into the core banking operations. A greater focus should also be put on staff training, system operations and re-aligning processes to maximize efficiency gains.

Also, regulatory bodies like the State Bank of Pakistan should also continue to provide support to stakeholders to further strengthen fintech adoption by providing a clear and adaptive fintech regulatory framework. Tools such as regulatory sandboxes, digital banking licenses, and cybersecurity guidelines can help reduce uncertainty and encourage innovation while safeguarding financial stability.

Hence to overcome lack of advanced skillset and knowledge regarding digitalization banks should ought to collaborations with third parties. This would be a better initiative than solely relying on in house production. Such partnerships would also be cost-saving for the firm from several aspects. Several collaborations have been initiated like the Bank Alfalah & Paymob (digital payments partnership), Bank Alfalah & QistBazar (Embedded Finance / BNPL Buy-Now-Pay-Later) collaboration, Faysal Bank & OPay, Faysal Bank & Smart1-Tech payment solutions, Meezan Bank & Payoneer etc.

5.2 Directions for Future Research on Fintech Adoption and Bank Performance

This research opens several avenues for future research. For instance, future studies may incorporate longer time horizons in their analysis as it is a notion that fintech benefits may take a longer amount of time to materialize rather than yielding results in the short run. Moreover, new collaborations are rising every day as banks are reaching new levels of adoption and such collaborations may also be used as a measure of fintech adoption in future studies. Future studies may also examine the moderating role of ownership structure or governance quality in shaping the fintech performance relationship. Such analysis may help explain heterogeneous effects across different types of banks. Future research may also incorporate banks of developed countries and how they tend to adopt fintech in their everyday operations and compare it to Pakistani banks to yield comparative results. Lastly, future studies may employ a mechanism of comparing structural and operational differences in Pakistani banks and Mashreq. Mashreq is a

major UAE-based financial institution known for its digital innovation and which has entered Pakistan's market as full-service digital bank and banks in Pakistan have already started strategic fintech partnerships with Mashreq anticipating major revenue growth by adoption of full digitalization.

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