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Fintech-Driven Transformation in the Islamic Banking Practices of Pakistan

Abstract

This study investigates the influence of FinTech adoption on the performance of the Pakistani Islamic banks. The study has made use of primary data collected from the 20 Islamic banks in Pakistan with the help of a questionnaire. The findings have shown that Pakistani banks are integrating the latest financial technologies like Machine Learning, Artificial Intelligence, Robo-advisors, and blockchain technologies, and it has resulted in their increased performance and competitiveness in the market. Findings of OLS have shown that FinTech adoption, along with competitiveness, has positively and significantly affected the performance of Pakistani Islamic banks. The study emphasizes addressing the need for modern technologies and infrastructure in the workplace. The finding contributes to the understanding of how FinTech has transformed the Islamic banking practices in Pakistan, by offering valuable insights for regulators, bank managers, and stakeholders aiming to leverage the latest financial technologies for increasing the market position and performance.

Keywords: Islamic Banking, FinTech, Performance, Competitiveness, Pakistan

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This study investigates the influence of FinTech adoption on the performance of the Pakistani Islamic banks. The study has made use of primary data collected from the 20 Islamic banks in Pakistan with the help of a questionnaire. The findings have shown that Pakistani banks are integrating the latest financial technologies like Machine Learning, Artificial Intelligence, Robo-advisors, and blockchain technologies, and it has resulted in their increased performance and competitiveness in the market. Findings of OLS have shown that FinTech adoption, along with competitiveness, has positively and significantly affected the performance of Pakistani Islamic banks. The study emphasizes addressing the need for modern technologies and infrastructure in the workplace. The finding contributes to the understanding of how FinTech has transformed the Islamic banking practices in Pakistan, by offering valuable insights for regulators, bank managers, and stakeholders aiming to leverage the latest financial technologies for increasing the market position and performance.

Keywords: [Islamic Banking](#), [FinTech](#), [Performance](#), [Competitiveness](#), [Pakistan](#)

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Introduction

The finance industry is modernising with the pace of digital knowledge (Hasan, [2023](#)). The sector is adopting digitalisation and innovation by adopting novel models of business. Innovations in the area of financial technology have the capacity to increase the infrastructure of financial firms and open new avenues for entrepreneurs. It also enables the banks to revolutionise their conventional business models and sell directly to the consumers (Sadiq, [2023](#)). FinTech has helped the banks in standardising their services

and decreased the likelihood of getting the personal data of their consumers into the wrong hands. The services provided by the FinTech banks are far better than those of conventional banks. Financial Technology is itself a formidable competitor in the banking sector, which is getting a larger portion of consumers (Aysan, [2022](#)). Traditional banks struggle to retain their customers; however, FinTech banks don't need to do that as they provide customised solutions to their consumers that help them in satisfying their needs. The application of FinTech in



the Islamic banking sector of Pakistan has revolutionised the whole sector.

Diffusion of innovation (DOI) theory has focused on the perceived characteristics of technologies. Moreover, it has targeted the innovation of the firms as well. The theory was proposed by Everett M. Rogers, and his book was published in 1962 and is known as Diffusions of Innovations. The theory provides information on how innovations adopt different channels for passing messages. It passes from change agent to early majority (Dearing, 2018). The theory proposes that firms and individuals use innovations related factors like visibility, flexibility, complexity, perceived advantage, and compatibility. This theory can be explained in the context of FinTech in the Islamic banking of Pakistan, as to how FinTech innovations are used by the banking firms in Pakistan. (Yahaya, 2016). The pioneering banks that have started using the latest financial technologies include the IT-savvy clients and liberal banks that have started using these digital platforms that have been approved by Sharia. The rate and level of FinTech adoption are based on how well these new technologies fit with the existing traditional systems of the banks.

The adoption of digital platforms is becoming crucial for the survival of conventional banks, especially in Pakistan. The finance sector of Pakistan is developing right now (Murad, 2023). Despite the growth of FinTech in the last decade, its adoption is still dependent on its fitness with the existing banking models. Only a small number of banks in Pakistan have adopted these latest technologies (Noreen, 2022). Different studies have been done on this area, but their focus was on conventional banks and not Islamic banks (Saba, 2019). Different scholars have argued that FinTech solutions are permissible under Sharia (Sidaoui, 2022). Moreover, these latest solutions also decrease the cost of the banks by earning a lot of profit from them. Islamic banks can increase their wealth by investing in these technologies. Therefore, this study explores how FinTech adoption and competitiveness improve the performance of Pakistani Islamic banks.

Review of Literature

FinTech is a combination of three expressions, which are related to financial services, technology, and finance. The financial sector is investing a huge capital in FinTech services as these provide them with a competitive standing among their rivals (Miskan et al., 2021). COVID-19 has negatively affected the financial performance of the banks around the globe, and it has shifted people to online banking methods. Moreover, it has also increased the amount of bad debts

(McKibbin and Fernando, 2021). Consequently, the global financial market has experienced a structural change in the last two decades, and every bank is investing capital in these Financial technologies as it is the demand of modern consumers.

Impact of FinTech Adoption on the Bank's Performance

FinTech adoption has increased the performance of the banks, and this phenomenon has been studied by different scholars (Dwivedi et al., 2021). The usage of digitalized financial knowledge in the finance sector is known as FinTech (Alam, 2019). Financial technologies have revolutionised the banking sector (Hasan, 2023). Studies have shown that it has directly increased the competitiveness of the financial sector (Arner et al., 2022). Moreover, literature has also found that it has resulted in the increased share prices of the firms in the stock market (da Silva, 2022). FinTech adoption has brought a revolution in the financial sector because now banks are relying on financial technologies and IT for increasing the efficiency of their system and operations (Karimova, 2025). The application of financial technologies has altered the conventional business models and is helping them to grab the new opportunities in the markets (Schueffel, 2016).

Financial technologies also help in the effective and efficient management of the firms. These technologies are providing benefits to banking firms and enabling them to modernise their financial services by incorporating digital technologies into them. Scholars have found that FinTech has improved the delivery of traditional services offered by banks (Elsaid, 2023). Modern banking applications have reduced the cost of operations. It has also reduced the cost of searching, which in turn has reduced the cost of browsing as well. Different studies have been done in different geographical areas of the world. For instance, Kharrat (2024) has explored the FinTech impact on MENA's markets and found significant results. Then, Siska (2022) has investigated the effect of FinTech on Islamic banks' performance by using the BSI as the single case study. He has included FDR, ROA, ROE, CAR, and BOPO, and found that all of these ratios have been significantly and positively affected by the FinTech adoption, and have increased the position in the market.

Studies have also found that customer are showing a transition to collect their receivables by the usage of online payment methods (Anastasiou, 2023). FinTech has brought more comfort, convenience, and affordability to the financial sectors of the world. It has also forced the banks to invest their capital in

communication and information technologies and infrastructure. Therefore, the banks have introduced both the national and international payment settlement methods (Alshater, 2022). Moreover, it has also resulted in the economic development of the countries.

Impact of FinTech on Islamic Banks' Performance

The banking industry of Pakistan has adopted these latest technologies, and this sector has shown progress and development. A recent study has shown that Sharia-compliant knowledge and services are improving the services of Pakistani Islamic banks (Marzuki, 2020). Literature has shown that the Islamic banking sector has adopted FinTech to retain its customers by providing them with online advice and payment systems (Helmi, 2024). Both Islamic and conventional banks are benefiting from these digital innovations and increasing their performance, stability, profitability, and operational efficiency. These latest technologies are also advantageous for the whole society because they enable the common man to manage their finances more easily with speed and efficiency.

Literature has also shown that there exist some social and cultural factors impacting the adoption of FinTech. The system of Islamic banks is based on Sharia. The people of Pakistan accept Islam and all of its principles for living their lives. Therefore, they want all of their transactions to be run as per their Islamic values. Therefore, the Islamic banks in Pakistan want only those financial technologies that are Sharia-compliant (Noreen et al., 2022). People of Pakistan make use of Islamic banking services like Islamic mutual funds, options, and Takaful through their phones (Rabbani, Khan & Thalassinis, 2020). These people prefer to use FinTech services on account of their simplicity, speed, efficiency, and straightforwardness (Varma et al., 2024).

The priority of the Islamic banks is to deliver only those services that show compliance with Sharia and result in the reduced cost of their operations as well (Rabbani, 2021). This innovation is helping the users by providing them with user-friendly interfaces and positively affecting the competitiveness and sustainability of the Islamic banks (Muneeza, 2020). These services are increasing customer satisfaction and getting their lifetime value as well. Overall, FinTech is creating ease for consumers by providing them with customised solutions as per their specific needs, wants, and demands. This, in turn, increases the financial performance of the Islamic banks. After reviewing the literature, the following hypotheses have been proposed:

H₁: FinTech adoption, along with competitiveness, has improved the performance of Islamic banks in Pakistan.

Methodology

The study has collected the primary data. The primary data has been collected with the help of a questionnaire, which has been distributed in the 20 Islamic banks of Pakistan. The respondents include the IT experts, top management, and people from the finance departments. The questionnaire has been administered online through Google Forms and circulated among the respondents. Moreover, the study has used purposive sampling for the collection of data. A total of 22 questions have been used. Four questions about the gender, age, experience, and job roles of the respondents. On the other hand, 8 questions were on FinTech Adoption, five questions on competitiveness, and 5 questions on the performance of Islamic Banks.

The data has been analysed with the help of SPSS. Initially, the descriptive statistics were used to check the characteristics of the data. Then, a regression analysis was run to find the effect of the adoption of FinTech on the performance and competitiveness of the banks. The subsequent regression was applied to study the relationship among variables:

$$\text{Performance} = \beta_0 + \beta_1 \text{FinTech Adoption} + \beta_2 \text{Competitiveness} + \epsilon_t$$

The Adoption and competitiveness are taken as the independent variables, while the performance of the banks is the outcome variable. ϵ_t is the error term that explains the difference between the forecasted and actual value of the dependent variable of performance.

Results and Discussion

The results are discussed below:

Descriptive Statistics

The demographic variables of gender, job, age, job role, and experience are shown in Table 1. The variable of gender ranges from 1-3, and its mean value is 1.25, which means the majority of the respondents are males. Then the minimum value of age is from 1-5, and the mean value is 2.68, which means the majority of the respondents fall within the age group of younger to middle-aged groups. The mean value of job role is around 4, which means these employees are working in middle-level positions. Similarly, the mean value of experience is 2.7, which means the majority of the respondents have 5-10 years of experience working with the organisations.

Additionally, data has also shown that the mean value of employees working with the firm is 2.245, which means these organisations have 25-50 people, which means these are small-sized banking corporations.

The values of standard deviations also confirm that all the values are within the acceptable range, which means their mean values didn't disperse much. For instance, the highest value of standard deviations is reported for job role, which is 1.85, and it shows

that a variety of people are working in the different departments of the organisation. On the other hand, the lowest standard deviation is reported for gender, which is 0.47 only, which means there is no variation in the data because the majority of the respondents are either males or females. Overall, the data has shown that the distribution is normal and can be used for further statistical analysis for studying the relationship among the variables.

Table 1

Descriptive Statistics

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
Gender of respondents	155	1.00	3.00	1.2452	0.47457
Age of respondents	155	1.00	5.00	2.6774	0.77238
Job role of respondents	155	1.00	7.00	3.5935	1.85058
Experience of respondents	155	1.00	4.00	2.7677	0.74572
Number of employees	155	1.00	5.00	2.2452	1.11857
C	155	1.00	3.00	1.2452	0.47457
P	155	1.00	5.00	2.6774	0.77238
F	155	1.00	7.00	3.5935	1.85058
Valid N (listwise)	155	1.00	7.00	3.5935	1.85058

Reliability Test

After checking the descriptive statistics, a reliability test was used to check the validity of the measuring instruments. The results are reported in Table 2, and they show the value of Cronbach's Alpha, which is

0.84. Its value should be greater than 0.70. The higher value of reliability shows that the measuring instrument is reliable, and there is no need to add or delete further variables in it to increase its reliability or validity.

Table 2

Reliability Test

Reliability Statistics	
Cronbach's Alpha	N of Items
0.804	3

Results of the OLS Regression Model

After checking the reliability and validity, the regression was run to check the effect of FinTech adoption on the performance of Pakistani Islamic banks. In this regression model, the dependent variable is the performance of Islamic banks. On the other hand, FinTech adoption and competitiveness are taken as the independent variables. Then, the number of employees working, gender, experience, job role, and age are taken as the control variables.

R has the value of 0,821, which confirms that a strong positive relation exists between the predictor and outcome variables. Moreover, the value of R-squared is 0.674, which explains the variability of the dependent variable. Then, the value of Adjusted R-Square is 0.659, which means around 65% variance in the outcome variable is explained by the variation in this model. A slight decrease in the value of adjusted R-squared from the value of R-squared confirms that the model is robust and it is not overfit.

Table 3

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.821 ^a	0.674	0.659	0.40391

Note: a. Predictors: (Constant), Number of employees, gender, C, experience, job role, F, age.

Results of ANOVA

The findings of the study show the value of Regression SS is 49.589, which shows the combined effect of all the independent variables. Then, the value of Residual SS is 23.982, which shows the value of variation in the performance of Islamic banks that cannot be explained by the independent variables of this model. Similarly, the value of total SS is 73.571, which is the total variation in the performance of the Islamic banks, and it is the sum of Regression and Residual SS.

Then, the value of the F-statistic is 43.423, and its related p-value is 0.042, which means the value is significant at 5% level. The value of the F shows the amount of variance in the performance of Islamic banks as compared to the unexplained variance. Overall, the significant value of F shows the robustness of the model in predicting the performance of Islamic banks in Pakistan.

Table 4

ANOVA Results

ANOVA						
	odel	Sum of Squares	df	Mean Square	F	Sig.
1	Regression	49.589	7	7.084	43.423	0.
	Residual	23.982	147	.163		
	Total	73.571	154			

a. Dependent Variable: P

b. Predictors: (Constant), Number of employees, Gender, C experience, Job role, F, Age

Regression Analysis

After ANOVA, the results of the regression are reported in Table 5. In this regression model, the outcome variable is the banks' performance. On the other hand, FinTech adoption and competitiveness are taken as the independent variables. Then, the number of employees working, gender, experience, job role, and age are taken as the control variables. The constant has the value 0.518, but it is not significant because its p-value is 0.095, which is higher than 0.05. This means the constant is not significant, and there is no need to add further variables to this model. Then, the value of FinTech Adoption is 0.230 and its p-value is 0.002, which means this variable is significant at 5% level and it is positively and significantly affecting the performance of Islamic banks in Pakistan. With a one-unit increase in the adoption of FinTech, the performance of Pakistani Islamic banks will increase by 0.23 units. Similarly, the value of competitiveness is 0.876 and its p-value is 0.000, which means this variable is significant at 1%

level and it is positively and significantly affecting the performance of Islamic banks in Pakistan. With a one-unit increase in banks' competitiveness, their performance would increase by 0.876 units.

As far as the control variables are concerned, the value of gender is -0.190 and its p-value is 0.011, which means this variable is significant at 5% level and it is negatively and significantly affecting the performance of Islamic banks in Pakistan. A one-unit increase in the age of the respondents means that moving more males to females will decrease the performance of Islamic banks by 0.190 units. Then, the values of age, job role, experience, and bank size are 0.056, 0.010, 0.012, and 0.013, and their related p-values are greater than 0.05, which means these variables are not significantly affecting the performance of Islamic banks in Pakistan. Overall, FinTech Adoption, Competitiveness, and gender are significantly affecting the performance of Islamic banks, while other variables do not have a significant impact on it.

Table 5.

OLS Results

Model	Unstandardized Coefficients		Unstandardized Coefficients	t	Sig	
	B	Std. Error	Beta			
(Constant)	-0.518	0.308		-1.681	0.095	
F	0.230	0.072	0.178	3.194	0.002	
C	0.876	0.066	0.736	13.257	0.000	
1	What is your gender	-0.190	0.074	-0.131	-2.562	0.011
	What is your age	0.056	0.059	0.063	0.953	0.342
	What is your job role	0.010	0.019	0.027	0.520	0.604
	What is your experience	0.012	0.053	0.013	0.230	0.818
	Number of employees working in your bank	0.031	0.036	0.051	0.868	0.387

a. Dependent Variable: P

Residual Statistics

The range of predicted values is from 2.31 to 5, as shown in Table 6. It shows the moderate variables in the variability of the outcomes. Then, the range of the residuals is from -1.38 to 0.97, and their mean value is 0. This shows the fitness of the regression model because the negative and positive residuals balance it out. Similarly, the value of standardised predicted values also has a mean of zero, and the range of their

standard deviation is from -2.78 to 1.95. This shows the spread of their values. Lastly, the value of standardised residuals has a mean of 0 and its standard deviation is almost 1, which confirms the normal distribution of the data. The minimum value is -3.41, and its maximum value is 2.40. This shows that some outliers exist in the data, but the residuals are within the acceptable range. The same data has also been shown graphically in Figures 1 & 2.

Table 6

Residual Statistics

Residuals Statistics					
	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	2.3138	4.9982	3.8892	0.56746	155
Residual	-1.37563	0.96795	0.00000	0.39462	155
Std. Predicted Value	-2.776	1.954	0.000	1.000	155
Std. Residual	-3.406	2.396	0.000	0.977	155

a. Dependent Variable: P

Figure 1

Residuals

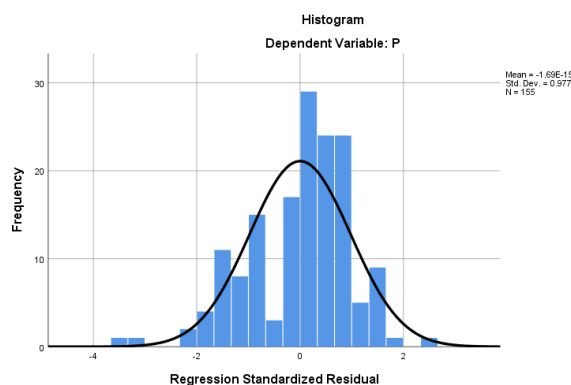
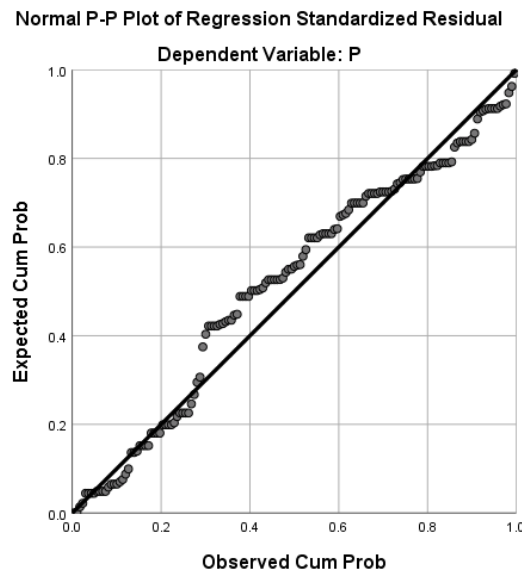


Figure 2

Normal P-P Plot



Conclusion

The study explored the effect of FinTech adoption and competitiveness on the performance of Pakistani Islamic Banks. The study has its grounds on the Diffusion of Innovation theory. The findings confirm the internal consistency of the measuring instrument and show that the findings are both reliable and valid. Then, the value of descriptive statistics has shown that the data is normal and can be used for further analysis. Moreover, it also shows that the majority of the respondents are males, aged 30-45, and holding managerial positions at their workplaces, and have significant experience working with their banks in Pakistan.

The robustness of the model is also confirmed by the ANOVA, which shows that the model can accurately predict the performance of the banks. Then, residual analysis confirmed the normal distribution of the data and acceptable dispersion around their mean values. The findings have shown that FinTech adoption and competitiveness are affecting the performance of the Islamic banks. On the other hand, the variable of gender is affecting it negatively; however, the rest of the variables have an insignificant impact on the performance of Islamic

banks. These findings underscore the importance of digital transformation within Islamic banks. FinTech is bringing a competitive edge to the banks because it helps them in meeting the modern needs of their consumers.

The negative impact of gender on the performance of banks has raised the points for policymakers and researchers to look at the role of workforce diversity in the banking population of Pakistan. Bank's CEO and policymakers should encourage a supportive environment at their workplaces that can encourage both genders to learn from their environment. Overall, the study provides valuable insights for policymakers. However, the data was limited. Further research can be done on a larger and diversified sample of data to check the longitudinal impact of FinTech adoption on the banks' performance. Moreover, further socio-cultural factors can also be explored. To recapitulate, the study shows that FinTech adoption and competitiveness have an important role in explaining the performance of Islamic banks. The latest Sharia-compliant financial technologies are playing a transformative role in modernising society and fulfilling the demands of consumers of the modern age.

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