

Special Report

Neobanks – The Future of Banking



Neobanks – Introduction

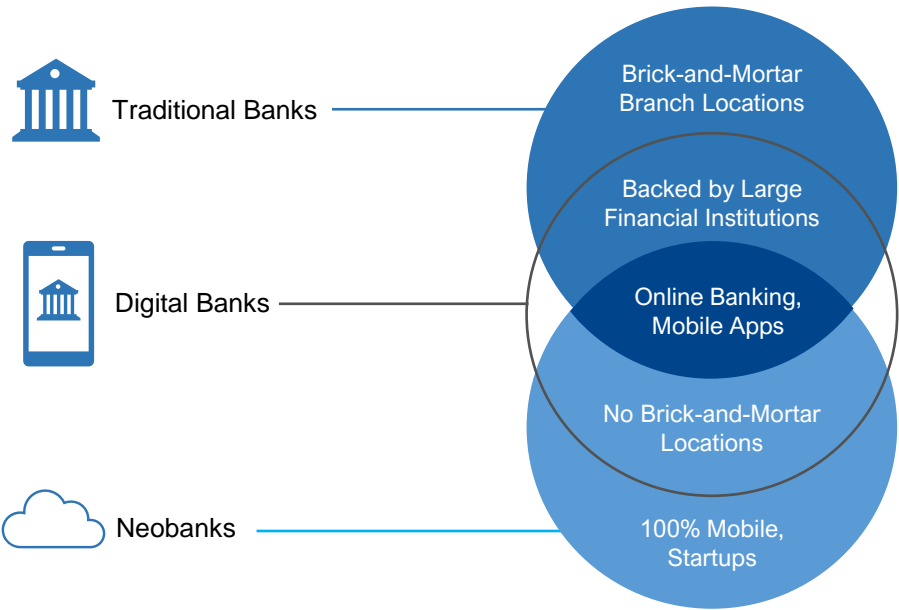
The new buzzword in finance

Neobank – The Ever-Evolving Definition

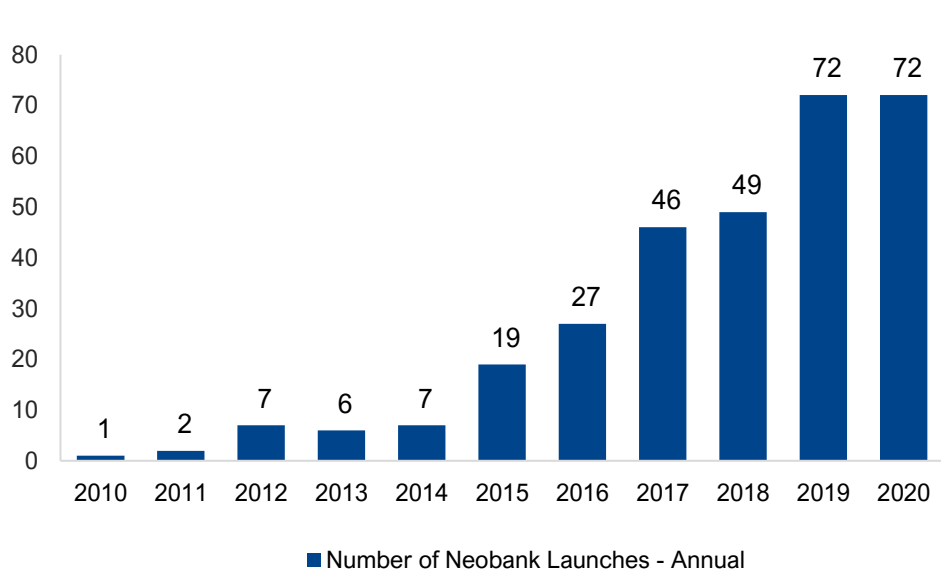
- A neobank was earlier defined as a bank with seamless online functionality that can directly interact with customers but without a physical presence. A neobank was perceived as an institution that provides better digital banking experience.
- The definition of neobanks has evolved as they have tried to differentiate themselves from the online services of brick-and-mortar banks and focused on providing superior customer and digital banking experience at less expense.

State of Neobanking Industry

- About 5–6 years ago, the neobanking industry and related activity were largely confined to Europe.
- Now, it has become a global phenomenon, with one neobank being launched every five days over the last two years worldwide.



Neobank Worldwide Launches From 2010



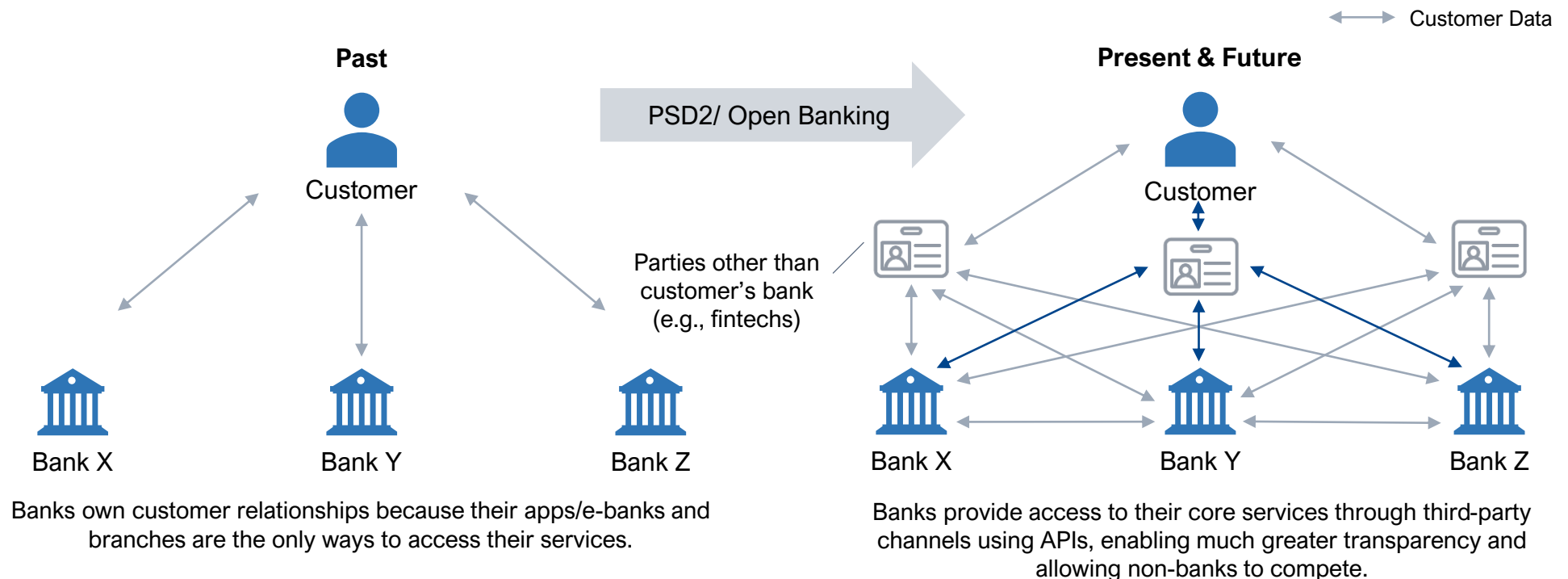
Source: Statista, Aranca Analysis

Evolution of global neobanking landscape

Early adopters and growing momentum

- The neobanking industry has witnessed strong growth across the globe.
- The UK had an early-mover advantage in the neobanking space due to early introduction of common banking guidelines for the EU. The first set of neobanks emerged from Europe. The PSD2 regulation allowed third-party access to APIs of incumbent banks. This open data sharing environment fostered the growth of neobanking fintech firms and acted as a precursor for the next banking revolution.
- Canada, the US, and several other EU countries followed suit, leading to the ever-growing prominence of neobanks.

Neobanks provide flexibility to customers and create a more competitive landscape.



Source: News Articles, McKinsey, Aranca Analysis

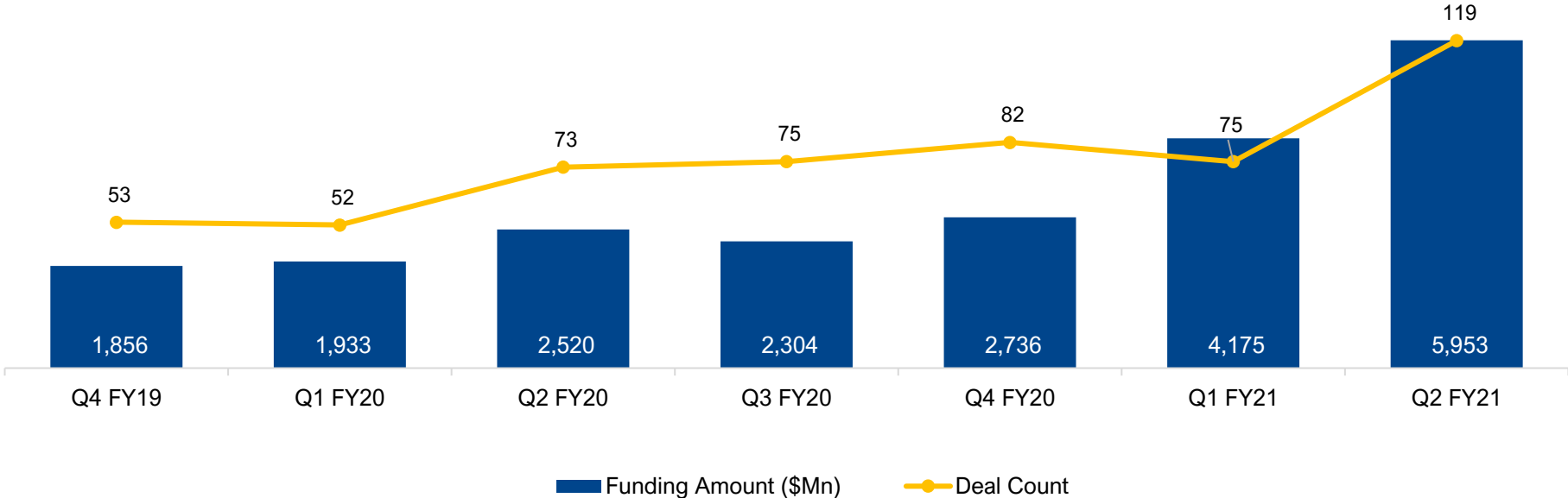
Note: PSD2 is a European regulation for electronic payment services

Shift from in-person to digital banking

Funding activity

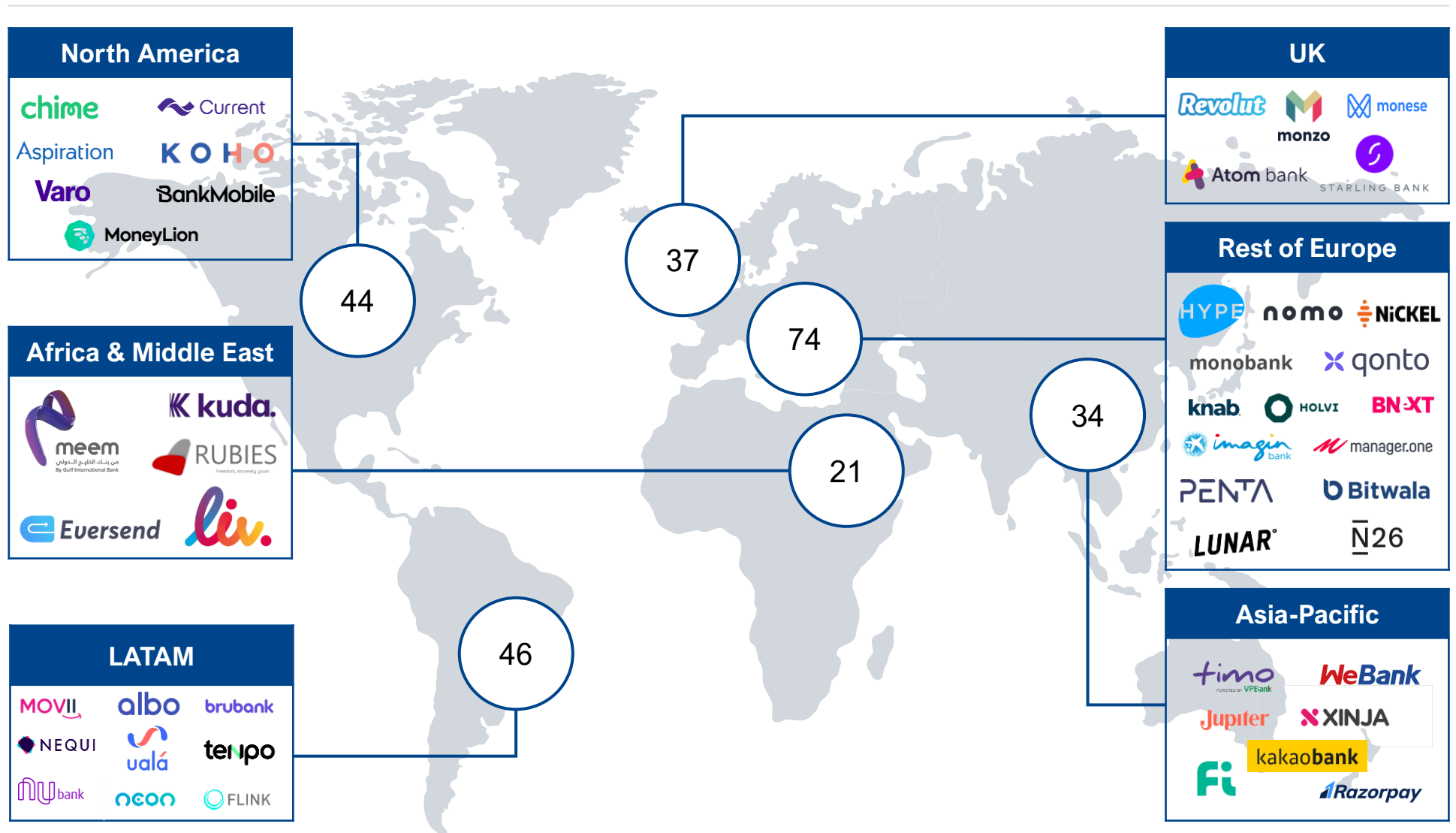
- The funding activity and number of deals closed in the neobanking domain reflect the increased interest in this sector. Neobanks saw consistent momentum in deal activity throughout 2020, despite the onset of the pandemic, and in some cases, buoyed by the pandemic.
- Globally, top neobanks have been able to attract the attention of investors and raise funding, as reflected in their high valuations.
- Investors have now fully realized the disruptive capabilities, innovative approach, and competitive advantages that neobanks bring into servicing customers as well as their potential to contribute to the global financial services industry.

Global Digital Bank VC Funding



Source: CB Insights, Aranca Analysis

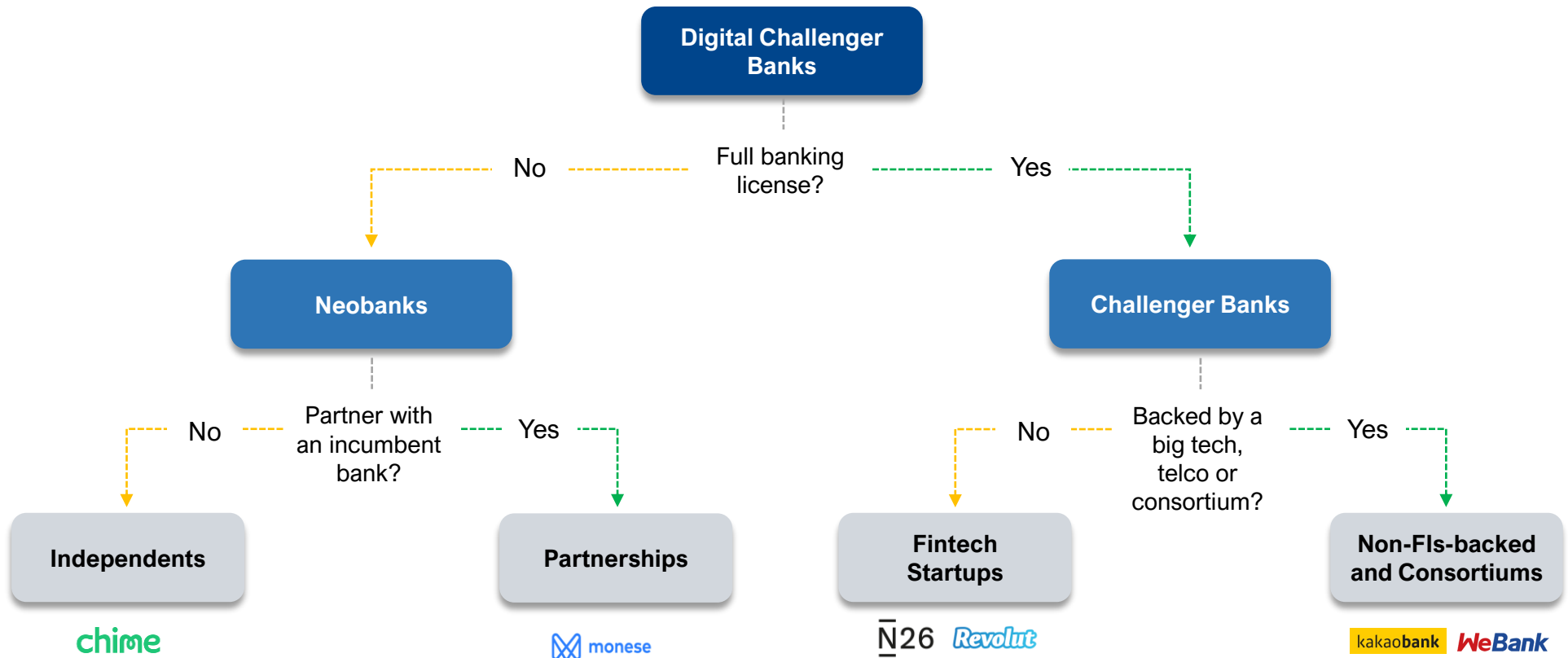
“Live” neobanks overview worldwide



Source: Pitchbook, News Articles, Aranca Analysis

Types of neobanks

- New digital banks are emerging to aggressively gain market share in the disrupted landscape of neobanking.
- Since 2010, over 200 digital challenger banks have been established around the world.
- Globally, there are three types of neobanks based on payments, experience, and credit. The first type makes payments faster, the second makes banking simpler, and the third offers flexible, convenient, and affordable credit.



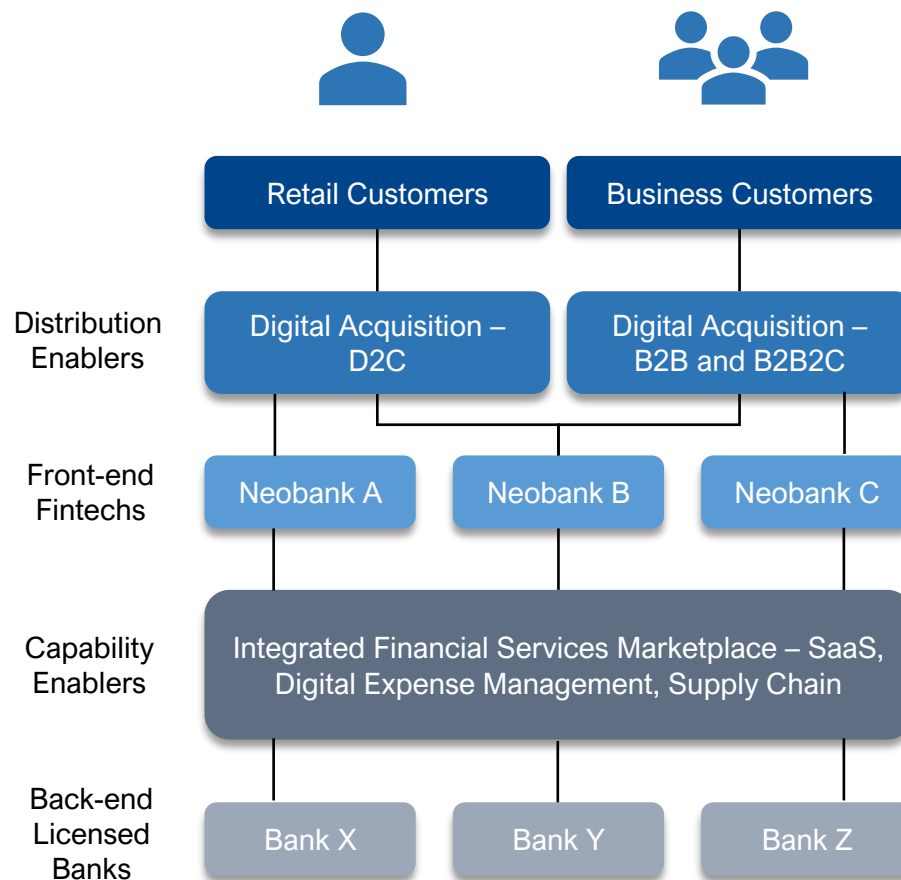
Source: News Articles, BCG, Aranca Analysis

Operations overview (1/2)

Neobanks thrive by disrupting banking system...

Operational Architecture of Neobanks






- Apart from technological innovation, neobanks' growth can be attributed to increased demand for instant and convenient solutions.
- Neobanks are uniquely positioned in the fintech space as organizations of all kinds, including big techs, software solution providers, and logistics and distribution companies, are offering financial services that are deeply embedded in their core product offerings.
- This in turn has led to the emergence of the following subcategories:
- **Pure-play Neobanks** – These include neobanks that are mainly digital in terms of core banking operations and customer-facing models, and that offer core banking and other value-added services.
- **Incumbent Digital Subsidiaries** – These include existing traditional banks that started with a brick-and-mortar approach and have invested significantly to transform into a click-and-mortar model.
- **Hybrid Banks** – These include a combination of the brick-and-mortar physical banking approach and virtual banking. This type primarily uses digitization as a means to offer banking products at lower costs without compromising quality.



Source: IFC, PwC, Aranca Analysis

Operations overview (2/2)

...with their customer-centric digital offerings

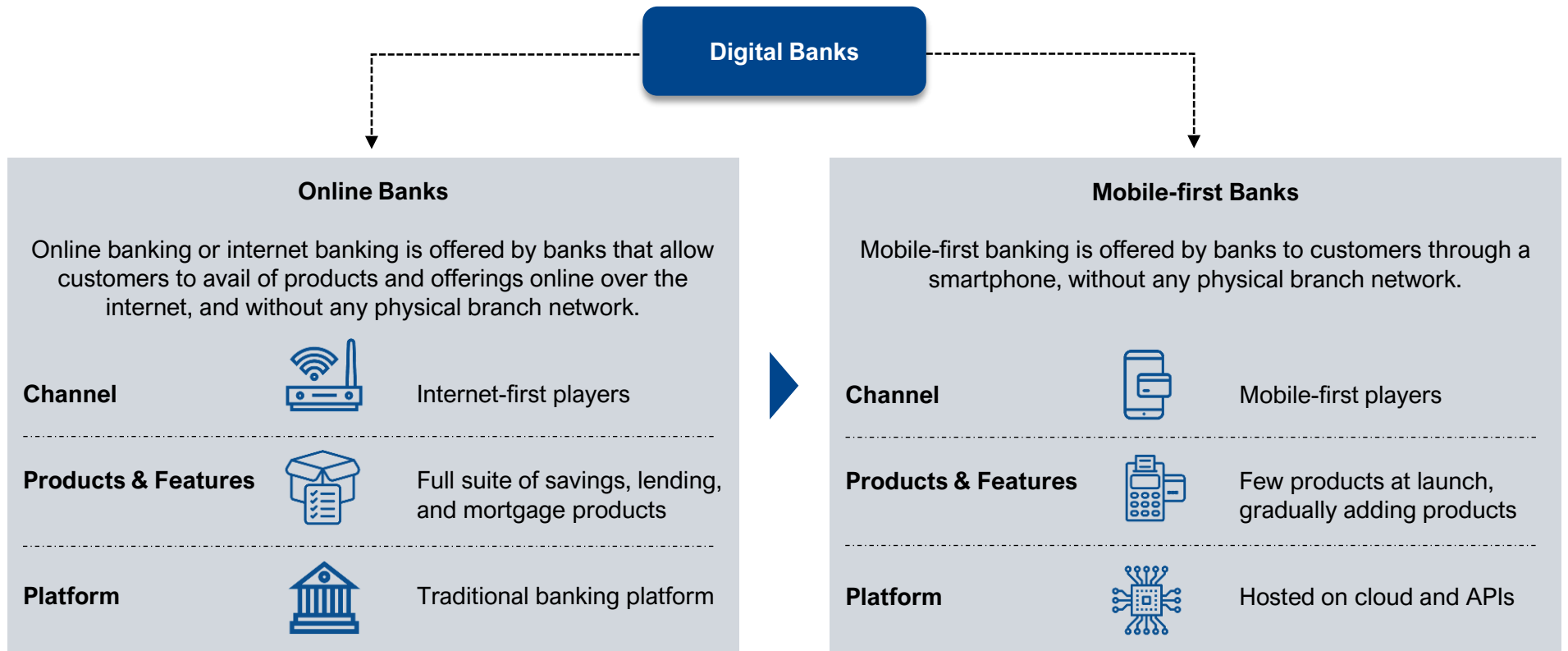
 Diversified Financial Products on Digital Platform	<ul style="list-style-type: none">• Deposits (CASA and Term)• Payments and Remittances• Accounts and Account Aggregation	<ul style="list-style-type: none">• Investments and Robo Advisors• Lending and Cards• Rewards and Loyalty Programs
 Digital Onboarding	<ul style="list-style-type: none">• e-KYC• e-Signature	<ul style="list-style-type: none">• Aadhar-based Authentication• Account Aggregator Linkages
 Digital Servicing and Engagement	<ul style="list-style-type: none">• Intuitive App• Chatbots	<ul style="list-style-type: none">• Virtual RMs and Call Centers• Contextualized User Experience
 Focus Segments	<ul style="list-style-type: none">• Millennials• Gen Z	<ul style="list-style-type: none">• Enterprises (especially SMEs)• Other Retail Customers
 Partnerships	<ul style="list-style-type: none">• Banks (X,Y,Z) to provide bank-like products / services, especially sourcing of deposits• Lending partnerships with banks, NBFCs, fintechs• Partnerships with insurance and wealth management platforms• Partnerships with platform enhancers and solution providers (e.g., gateway)	
 Licenses and Regulation	<ul style="list-style-type: none">• Bank Licenses – as per Regulations• Broking and Agency Licenses	<ul style="list-style-type: none">• Remittance Licenses

Source: RBI, Aranca Analysis

React and Respond

From bricks to clicks

- The widespread use of internet in the early 2000s led to the first wave of digital disruption as many incumbent banks transitioned to internet-based offerings.
- In contrast, the new wave of digital and neobanks is mobile-first, driven by rapid global mobile adoption.
- Countries such as the U.S. and Australia have licensed neobanks, unlike India. Neobanks collaborate with commercial banks to provide solutions across business segments by leveraging technology.



Source: BCG, Aranca Analysis

Strategic business advantages

Neobanks a preferred choice for various reasons

Neobanks are completely digital and they have the flexibility to provide cost-effective, seamless, integrated, and a wide range of services to customers. These, along with a customer-centric approach, are some of the factors driving the success of neobanks globally.



Convenient and Easy to Use

Ubiquitous banking is one of the biggest benefits that consumers and businesses gain via neobanking as all operations can be carried out online.



Enhanced Customer Experience

Neobanks offer a seamless and unique customer experiences as opposed to the mainstream traditional netbanking interface.



Lower Operational Cost

Neobanks are cost-effective compared to traditional banks as the operations are completely digital and require less manpower.



Real-time Payments

Businesses can make vendor, employee, customer, and partner payouts without having to deal with multiple platforms.



Security & Transparency

Businesses can transact with money easily. The transactions are almost instantaneous and efficient, while customers can track money in real-time.



Smart Reporting

Neoapps provide an overview of expense, along with a customizable savings goal and smart reporting.

Key trends influencing the neobanking industry

Major drivers creating new reality and triggering need to reprioritize actions

- Many sectors were hit by COVID-19, and the neobanking industry is no exception.
- Lockdown created a favorable environment for digital and neobanks, as the situation allowed them to manage onboarding and key servicing processes remotely.



Increasing competition – Over 250 neobanks have been launched to date. Incumbent banks, which are waking up to the threat of digitization, are raising the bar for successful and differentiated services being offered by neobanks.



Coming of age – As neobanks are increasingly becoming an integral part of the ecosystem, reaching their definition of scale (several million customers) and subsequently achieving breakeven, investors are anticipating a shift from cash burn to monetization.



Stricter regulatory scrutiny – Neobanks have emerged as an institution of aid for the banking sector and financial services industry at large and are no longer considered as rookie banks.



Increased complexity within multinational banks – Banks have started to realize the difficulties associated with competing on multiple fronts and dividing management attention between them.



COVID-19 changing the parameters of retail banking across the globe – Rising credit defaults, increased customer willingness to shift to digital payments, lockdown-induced restrictions and increase in non-performing loans, especially consumer loans, are some of the impacts of the pandemic.

Outlook

Incredible promise for future; expected to become mainstream with increased adoption

- Over the past five years, the global neobanking industry has witnessed exponential growth in terms of customer base and the size of the overall market.
- Although neobanks have gained momentum and traction, and also have significant potential to disrupt the banking and financial services sector, the operational model is yet to show sustained profitability.

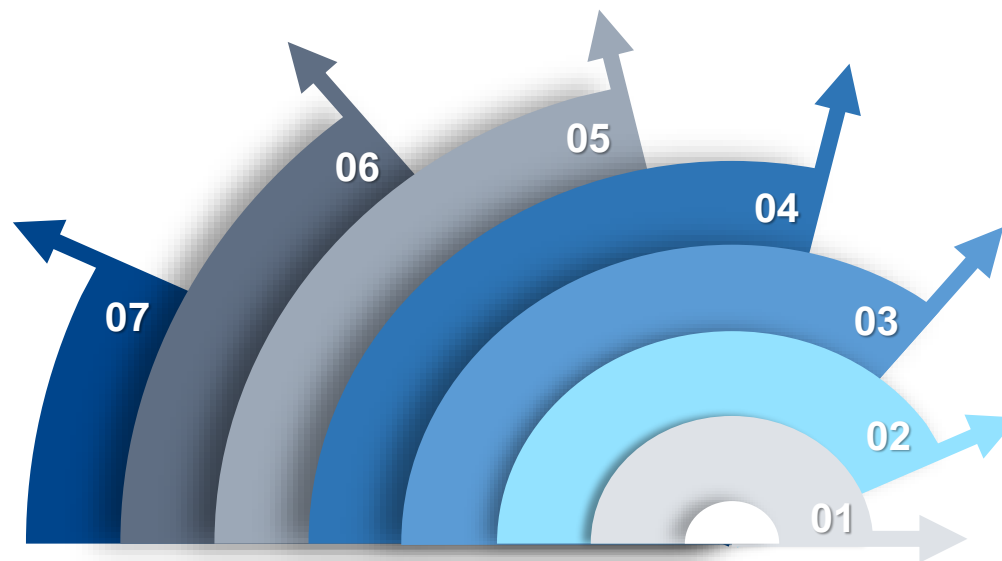
White space remains in Poland, Japan, and Germany for innovation and growth. Increased activity in these countries is expected in the years to come.

Other global markets such as South Korea, Brazil and the US are soon catching up.

Europe is the frontrunner for innovation in the neobanking industry. It has three of the five **most advanced neobanking markets**: the UK, Sweden and France.

The **wave of digitization** is here to stay. Traditional banks are expected to invest more in enabling technologies.

Neobanks, with their tech-enabled solutions and offerings, have an opportunity to become the frontrunner in the domain, capture market share, and set themselves on the path to profitability.



In the **ever-evolving regulatory landscape**, neobanks can play a crucial role in addressing the requirements of MSMEs and retail customers, beyond traditional banking, in an integrated and seamless manner.

Neobanks are **building niche solutions** focused on specific groups of customers, which has earned them a major role in the larger financial services ecosystem.

The **global neobanking market size** is expected to reach USD333.4 billion by 2026, registering a CAGR of 47.1%, over the next five years.

Source: KPMG, Aranca Analysis



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120+

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Countries where we have delivered projects

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