

# THE EMERGENCE OF NEO BANKS: TRANSFORMING THE BANKING INDUSTRY

## Abstract

Neobanking, a Fintech-powered concept, operates entirely in the virtual realm without a physical bank presence. This innovative approach allows neobanks to function as fully sustainable financial institutions, benefitting their customers as well. This paper aims to explore the potential scope of Neobanking in India and analyze the opportunities and challenges it presents from the customer's perspective, based on a thorough literature review.

**Keywords:** Neo Banks, Digitalization, Structure of Neo Banks

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## I. INTRODUCTION

The advancement of banking has led to the introduction of a diverse range of products and features, offering simplicity and preference tailored to the convenience of customers. Over the past two decades, the traditional banking system has undergone a transformation into digitalization and core banking. Banks now offer not only basic services like deposit acceptance and money lending but also various utility services and innovative financial products, enabling them to gain a larger market share.

The speed of banking transactions and settlements has significantly improved, with settlements now occurring within a day or within 3-4 working days, mainly through systems like NEFT and RTGS. In businesses, regardless of their scale, electronic clearance plays a crucial role in handling substantial transactions. Neobanking, a fully digitized platform without a physical bank presence, has emerged as a concept that ensures high-security levels for banking transactions.

The history of neobanks traces back to Europe, particularly in the UK, US, and other European nations, which have now established a strong base for neobanking worldwide. Presently, there are around 100 neo banks operating globally.

In any nation, the key to development lies in embracing adaptation, digitalization, and modern banking techniques to foster economic growth and seize market opportunities. Studying upcoming and high-potential concepts is vital to gaining a market perspective and being open to necessary transitions.

In light of this context, the current study focuses on the concept of neobanking, exploring its opportunities and challenges. The perspectives of customers of Indian origin are taken into consideration during the assessment of neobanking's potential impact, drawing insights from previous research (Rup et al., 2018, 2021).

## II. DISCUSSION

A substantial body of literature exists on the utilization of modern technology in the global banking service delivery system. While certain studies delve deeply and comprehensively into the subject matter, others have a narrower focus and limited coverage. Some research adopts a highly reliable approach, while in other cases, the methodology may lack empirical rigor.

- 1. Emily Soreson (2019):** This paper aims to compare traditional banks with a new banking system known as Neo banks. The article categorizes Neo banks as fintech solutions due to their capacity to operate online and through apps. The study highlights that Neo banks are fully digital, setting them apart from traditional banks, which has resulted in a slower rate of gaining customer support for the former. Traditional banks, being equipped with full bank licensing, have their services regulated accordingly. One significant distinction between the two types of banks lies in their physical existence, as Neo banks do not have any physical branches. The study concludes that Neo banks offer more cost-effective services, but traditional banks outperform them in terms of the breadth of services provided. This discrepancy could be attributed to Neo banks being relatively new, having been established only within the last five years.

- 2. Rene Hendrikse, EMEA MD, Mitek (2019):** In this paper, the researcher explores A.T. Kearney's theory, which predicts that 1 in 10 banks will cease to exist within the next 5 years. Concurrently, there is an anticipated surge of Neo banks in Europe, driven by their innovative models in the digital realm. The theory suggests that more than 85 million Europeans, approximately 20% of the population over 14 years old, will become customers of these Neo banks. The growth of European fintech has been facilitated by open banking, which, according to the study, will further bolster the rise of Neo banks in the near future. The study highlights the success of certain prominent Neo banks, such as the UK's Revolut, which has already attracted over 4 million customers. It concludes that these Neo banks are rapidly catching up with traditional bank offerings, as several newcomers are already making their mark in the market.
- 3. Vanita D'Souza, Entrepreneur (2019):** The study focuses on the transformation of the banking industry in the new era, driven by changes in the ecosystem. The researcher acknowledges the significant impact of technology, exemplified by the launch of ING's digital bank. Regarding the opportunities for Neo banks, Bagri suggests that India is still in its early stages, and domestic digital banks might adopt European models to scale their operations, allowing multiple open banks to cater to specific niche demands. With India's large customer base, the researcher sees enormous potential for Neo banks in the country. The study points out that unlike other countries, there are no specific regulations for these banks in India, and they adhere to traditional banking laws. The article concludes by emphasizing that these banks are adding value to the Reserve Bank of India (RBI), and therefore, RBI should establish a separate licensing category for digital banks.
- 4. Keshav Bagri (September 21, 2019):** This paper aims to assess the performance and potential of Neo banks in the global market. The researcher evaluates its significance by considering the global market size and drivers. According to Allied Market Research, the global neobank market has witnessed substantial growth, with a 50.6% increase from 2017 to 2020. Lower interest rates and convenience are identified as the major factors contributing to the rapid growth of Neo banks. The study delves into the market trends of different countries, revealing that Neo banks have experienced varying degrees of success on a global scale. Funding for Neo banks has been substantial, with 55 recent deals from Venture capitals recorded worldwide. One of the primary challenges identified is the profitability of Neo banks, as customers tend to try them out but still prefer to use traditional banks as their primary accounts. Ultimately, the study believes that Neo banks have a high likelihood of becoming mainstream in the banking industry, and Indian startups should draw lessons from the strategies employed by larger global players to succeed in this domain.
- 5. Yash Agarwal (2019):** This article discusses the rise of Neo banks as the second phase in India's banking sector, following the initial phase when startups introduced the "Digital Banking" model. The researcher outlines the wide range of services offered by these banks, highlighting how they have evolved from traditional banking to encompass functions such as invoicing and automated book-keeping within a single platform. However, due to regulatory challenges, Neo banks find themselves in a regulatory gray area. To overcome these regulatory obstacles, the article reveals that Neo banks have formed partnerships with traditional banks, allowing them to operate under the regulations set by the Reserve Bank of India (RBI). Despite these challenges, the researcher remains optimistic about the growth of Neo banks and Indian fintechs, which

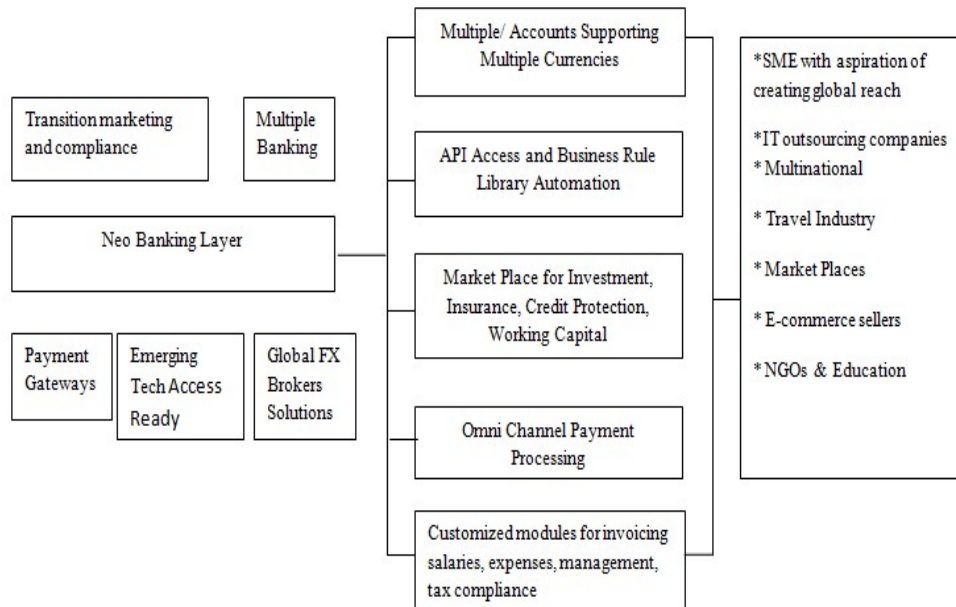
are gaining traction in the country. The article concludes by emphasizing that consumers stand to benefit the most in this competitive fintech landscape.

6. **Jo Brokhurst (2019):** The study explores the potential success of neobanks in the market. The researcher specifically focuses on the Australian market and its banking customers, revealing that approximately 2.1 million customers are considering switching their main financial institution to neobanks. This trend is attributed to the significant impact of advancements in banking technology, as a majority of customers prefer the ease of use offered by neo banks over traditional banks. The article draws a distinction between traditional banks and neo banks based on their physical presence, highlighting the absence of brick-and-mortar locations for neobanks. In Australia, neobanks have gained traction among millennials, providing them with a clear advantage and potentially offering better deals to customers. In conclusion, the researcher underscores the importance of brand trust, engaged employees, innovation, and, most importantly, customer experience in the success of neobanks. These factors play a crucial role in shaping the future of banking in the evolving market landscape.
7. **Amruth Raj Nippatlapalli (2013):** The study aims to analyze the global performance and impact of Neo-Banks. It assesses the growth and regulatory landscape of neo-banks in five different countries. Additionally, the paper sheds light on the current market situation of the banking industry in India and predicts the potential outcomes in the fintech world with the emergence of neo-banks. By delving into the workings of neo-banks, the study provides potential customers with insights into their expected operations and highlights the importance of establishing appropriate regulations for this new form of banking.
8. **Shaza W. Ezzi (April 2014):** Neo Banks face a growing challenge to cater to customers' demands for digitalization. In today's world, people handle various aspects of their lives through their smartphones, and they seek convenient and user-friendly applications to facilitate this. Internet banking adoption is notably high in Europe, particularly in Denmark, where 90% of the adult population utilizes it. Although mobile banking hasn't reached the same level of adoption yet, it is rapidly increasing, as evidenced by last year's statistics, which indicated that 64% of smartphone owners in Europe used their devices for banking purposes (eurostat, 2018).
9. **Shilpi Khandelwal (2013):** The end value represents the culmination of all the features integrated into services. This encompasses crucial aspects of services that enhance customer satisfaction levels in neobanking. It includes factors such as service image, consumer well-being, and service quality. The management places significant emphasis on these end value factors to positively influence consumer perceptions. Accordingly, the management needs to pay close attention to customer interactions and practices, continually reviewing and enhancing service quality to elevate customer satisfaction in the services industry.
10. **Bahram Meihami, Zeinab Varmaghani & Hussein Meihami (2013):** Neobanks, while offering similar core services as traditional banks, have distinct business models due to the absence of branch networks. As financial technology companies, neobanks opt to create their own IT systems from scratch, utilizing cloud-based operating system providers like Amazon Web Services, instead of relying on pre-existing systems

purchased by traditional banks. Rifat O. Shannak (2013) highlights that traditional banks often depend on costly and slow-to-implement core banking systems. In contrast, neobanks employ a network of microservices, operating as separate components that are integrated together, leading to more agile and efficient processes. As a result, implementing changes in neo banks typically takes around 2 weeks, in stark contrast to the 3-6 months it may take for traditional banks.

- 11. Dr. G S Gireesh Kumar, Bijoy A P and Ajimon George (2012):** The study centers on how the absence of branches and the heavy reliance on technology empower neobanks to swiftly adapt to changes and introduce new features. This approach also leads to a substantial reduction in operating costs, enabling them to offer more competitive fees to their customers. The researcher offers insights on how neobanks can enhance their practices, such as releasing yearly financial reports, openly documenting challenges and successes on their blog, and adopting a less corporate tone in their interactions with customers.
- 12. According to Isoraite (2018):** In the year 2014, the majority of current account holders decided to switch their bank accounts, and approximately 1.16 million customers expressed dissatisfaction with the banking services they were receiving. This noteworthy shift in consumer perceptions towards the banking sector highlights the importance of recognizing and addressing the underlying issues. Numerous research studies have been conducted to understand the factors influencing consumer perceptions. The research by Rintamäki, Kuusela, and Mitronen (2007) identified that services and safety are significant factors in consumers' minds. Consumers seek a sense of safety and security in their financial arrangements. In the UK, banks such as Barclays, Lloyd Group, HSBC, and Royal Bank of Scotland have recognized the importance of meeting consumers' needs and have been striving to deliver top-notch services. Nevertheless, they continue to focus on enhancing their banking services to better cater to their customers.
- 13. Structure of NEO Bank:** Neo Banks are banks centered around digital platforms, leveraging partnerships with other financial institutions to operate efficiently. These banks primarily function in a virtual manner, integrating Artificial Intelligence and Information Technology to offer their services.

Neo Banks can be categorized into three major structures:



Source:- Report on Neo Banks: Future of Indian Banking, Feb 2022

- **Core Infrastructure:** Neo Banks play a vital role in offering backend support to their partnering banks. They provide solutions and address grievances raised by the customers of these partnering banks.
- **B2B/B2C Model:** Neo Banks operate through this platform to offer comprehensive services to the customers of their partnering banks, catering to both business-to-business (B2B) and business-to-consumer (B2C) needs.
- **Users:** Neo Banks have a diverse range of end users for the services they provide. Companies in the IT and financial sectors are among those opting for the services offered by Neo Banks.

**14. Neobanking: Challenges:** Every project and initiative comes with its own set of drawbacks and limitations. As a new paradigm, neobanking also faces certain limitations typical of any initial project:

- **Lack of Personal Interaction:** While the complete online nature of neobanking offers advantages in terms of cost reduction, it does compromise on physical personal interaction since there are no physical branches involved.
- **Cash Payments:** Despite the increasing trend of Indians engaging in online shopping and transactions, cash on delivery remains a preferred mode of payment at the payment gateway in many cases. Neobanks need to address the need for making physical cash available and consider alternative income sources beyond payment gateways.

- **Limited Financial Products:** Neobanks, not being fully licensed banks and operating under the umbrella of another registered bank, offer limited financial products. Certain loans and deposit schemes are not currently available through neo banking. Their development depends on the growth, acceptance, and transparency of neobanking.
- **Safety and Security:** Customer concerns regarding the safety of their funds in online and mobile transactions are paramount. While neobanking operates under the governance of a regulatory body in each country, increasing awareness and assurance among customers regarding the security measures in place is essential.

### III. CONCLUSION

Neo banks are revolutionizing the banking industry by introducing a plethora of new user data through their user-friendly interfaces, aiming to facilitate hassle-free transactions. These innovative banks also play a crucial role in fund creation and proper allocation to designated accounts, ensuring effective oversight by the government. They have rightly identified the gap between the needs of the customers and the services offered by traditional banks. The services provided by them ensure seamless services provided to the customers. They also ensure that the customers have a hassle free transaction.

Neo banks primarily target SMEs, recognizing their significance in the country's development while keeping costs to a minimum. As a result, they emerge as an ideal banking solution for swift payment and collection processes, as well as for ensuring compliance with tax regulations. Many neo banks even offer the added convenience of enabling customers to file their GST return and handle other indirect taxes

On the basis of our review we recommend that traditional banks can explore collaborations and partnerships with these fintech companies to leverage their innovative solutions and technology. By working with collaboration of fintech companies, they can create new and improved digital banking products, mobile apps, upgrading online banking platforms, and incorporating advanced technologies like artificial intelligence and machine learning and personalization for their customers.

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