

Neo-banks: disruption at play?

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Key takeaways:

- *Neo-banks can play an important role to address SME, MSE and retail individual customer requirements beyond traditional banking in a seamless and integrated environment*
- *In India, banks and neo-banks have struck a collaborative partnership. While banks remain the money custodians, neo-banks are emerging as the crucial data and technology via medium for empowering the customer.*

Neo-banks are disrupting the banking system with their customer-centric digital offerings across retail and Small-to-Medium Enterprise (SME) banking, remittances, money transfers, utility payments and personal finance. They focus on applying design thinking approach to a particular banking area and tailor their products, services and processes in a manner that makes banking simpler and convenient. This has provided a differentiated experience to the end user, resulting in higher client adoption rates.

Globally, top neo-banks have captured the attention of investors, which is reflected in their high valuations. Neo-banks are able to attract funding due to their disruptive capabilities and innovative approach to the way financial services are offered. For example:

- A U.K.-based Neo-bank is now the most valuable fintech firm at ~USD30 billion as of 2021 as it raised USD750+ million for product development and expansion.
- A U.S.-based startup that delivers mobile banking services (like savings account and VISA debit cards) was valued at USD14+ billion in 2020.
- An e-commerce giant, a multinational technology company and a multinational financial services corporation are separately eyeing a stake in a neo-bank, which is looking to raise ~USD100+ million. If it does manage to raise the amount, its valuation is likely to jump three times to around USD600+ million.

The global neo-banking market size is expected to reach USD333.4 billion by 2026, a market growth of 47.1 per cent CAGR over the next five years. ¹

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Countries like the U.S. and Australia have licensed neo-banks, whereas in India, these are not licensed banks. Neo-banks collaborate with commercial banks to provide better adoptable solutions across business segments with the use of technology like open banking APIs, artificial intelligence, machine learning and data science. This dual combination creates value as the Neo-bank handles technology and innovation while the licensed bank handles trust, franchise, risk, underwriting and collections. Low-cost operations of neo-banks result in better offerings and promotes business. However, the key value addition that neo-banks provide is a seamless and integrated customer experience while managing their financing and business banking needs. This is done through providing an integrated platform for automated transaction banking, payments, tax compliance, accounting services, investment needs, etc.

Case study 1 - Building current account balances with SME focus

A Neo-bank offers a business banking platform over current accounts that helps SMEs automate and run their finances effectively. This platform seeks to integrate banking into an SME's business workflow through APIs, instant receipts and payments gateway, real time cashflow monitoring, automated accounting and bookkeeping, payroll management, and vendor management. The platform is estimated to process USD10-15 billions in transactions annually with its multiple bank tie-up.

Case study 2 – Enhance retail customer experience of a traditional bank

While attempting to provide better customer experience, traditional banks face challenges of seamlessly integrating different platforms that run processing, card controls, authentication, rewards, etc. A Neo-bank helps such banks by providing a single integrated, modular, cloud-native, mobile first, banking platform that enables financial institutions to provide next-gen banking experiences to customers, thereby increasing customer engagement, retention and revenue. The customer gets a high degree of personalisation through value-added features like faster account opening, simplified money tracking, smart reporting, low cost international payments and money transfers, better interest rates on loans and deposits, globally accessible debit cards, etc. These measures result in higher adoption rates.

In India, banks and neo-banks have struck a collaborative partnership. While banks remain the money custodian, neo-banks are emerging as the crucial data and technology via medium for empowering the customer. However, this can also be seen as a roadblock for the neo-banks as they might never be allowed to operate independently, and the rising number of emerging fintech companies are making the environment highly competitive. Although neo-banks are scaling up their presence, there is a lack of regulations as the 100 per cent digital bank model has not been permitted in India yet.

In summary, as the regulatory landscape evolves, neo-banks can play an important role to address SME, Midsize Enterprise (MSE) and retail individual customer requirements beyond traditional banking in a seamless and integrated environment.

¹ NEOBANKING MARKET SIZE, kbv research, February 2021