

# The Rise of Neobanks: Disrupting the Traditional Banking Landscape

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**Abstract:** *Neobanks are online - only, digital - only financial institutions. They are, to put it simply, non - existent. Customers may need to invest a significant amount of time and effort in typical bank transactions. Neobanks add an immersive digital layer to traditional banking, promising a smooth online experience. [1] Neo banks frequently provide a comprehensive array of financial services that may be accessed via their mobile applications or websites, such as checking and savings accounts, loans, payments, investments, and budgeting tools. Neo banks place a high priority on data privacy and security. [2]. Nonetheless, new banks continue to face difficulties with regulatory compliance. Opportunities might be found in developing user experience technology and providing creative, customised financial products. Neo banks are becoming more and more popular, but traditional banks won't likely disappear anytime soon because both may survive and meet distinct client needs in the changing banking environment. [2]*

**Keywords:** neo bank, fintech, traditional banking, customer experience

## 1. Introduction

Neo banks, sometimes referred to as challenger banks or digital banks, are financial organisations that only conduct business online and don't have any physical locations. They are a particular kind of fintech business that uses technology to provide cutting - edge, client - focused financial services. Neo banks leverage their digital platforms to offer a smooth and intuitive banking experience, with the goal of upending traditional banking. [1]

On the other hand, neo banking policies have changed a little. For example, alternative lenders now often focus on embedded finance and use - case focused loans rather than solely on pure - play lending platforms and markets. Participants in other FinTech sectors have also adopted this strategy to more sustainably generate demand and spur product innovation by integrating financial services into larger client demands. The potential to enable transactions at the source, the digitization of the entire banking and transactional process, and the modernization of antiquated systems and customer service practices are driving the broad development and deployment of embedded finance. [2]

## 2. History

Millions of jobs and trillions of dollars' worth of financial capital were destroyed because of the global financial crisis of 2008. Many people primarily hold the banking sector accountable for this financial capital loss. Neobanks, also referred to as challenger banks, are a new breed of financial institution that emerged because of the public's declining

faith in traditional banks. Increased industry openness was facilitated by the EU's new Payment Services Directive (PSD), which was incorporated into law in November 2009. PSD 2 further updated the sector, allowing Neobanks to enter the market. [3]

The banking sector has historically operated as a monopoly, but because of the EU's progressive financial legislation, new competitors now have access to the market. Neobanks have been able to cut costs and provide their basic banking services at a lower cost than the traditional players in the market because they do not have any physical branches. [3]

### Rise of Neobanks and Disrupting the Traditional Banks

Not only have venture capital firms made large investments in neobanks, but they have also drawn a lot of attention. Neobanks managed to raise over \$12 billion internationally in 2021, even with the world economy contracting because of Covid - 19. This kind of funding transcends national boundaries. There were 333 digital - only banks in 2021 compared to 250 in 2020. [4]

The banking ecosystem has radically transformed because of economic uncertainty, greater competition from digital - only banks, swiftly shifting client demand, and rapidly advancing technology. Traditional banks have been forced to reprioritize their long - term vs. short - term aims. The fundamental elements of a conventional bank, however, such as high operating expenses, the strain of back - office operations, constraining banking processes, resistance to changing antiquated systems and beliefs, and so on, become part of the opposition to necessary adjustments. [4]



### Causes of disruption in the banking space



Sources: Capgemini Financial Services Analysis, 2021; World Retail Banking Report 2021 Executive survey, N=122. Question: Which of the following factors are causing business disruptions in the banking sector?

[4]

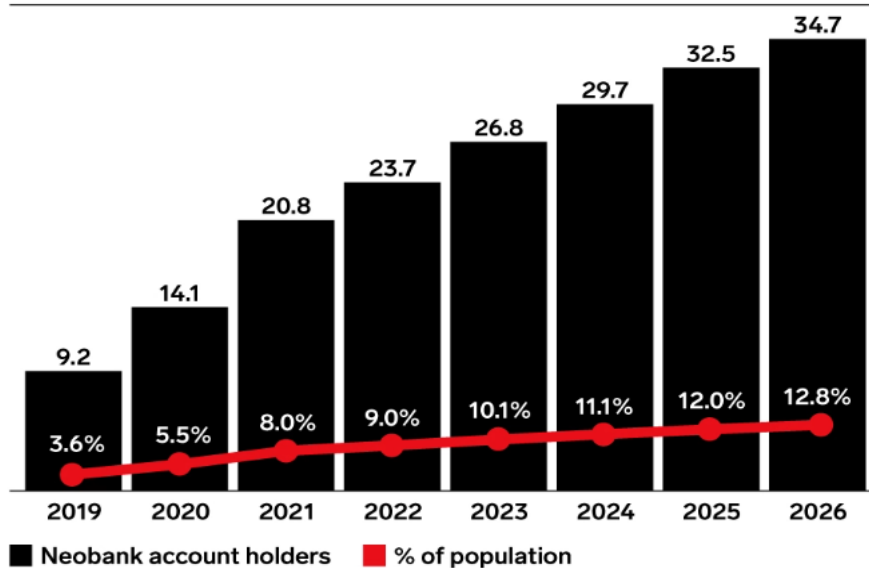
Neobanks continue to encounter some obstacles in their attempts to upend the established banking sector. Building trust with clients is one of their toughest obstacles because many people are still hesitant to entrust their financial matters to an entirely digital platform. Neobanks also must contend with fierce rivalry from traditional banks, which have substantial resources and well - established names. [5]

### 3. Future

In the US, neobanks have become a serious challenge to established banks. However, neobanks confront serious obstacles in addition to growing in prominence and influence. In fact, Insider Intelligence data indicates that neobanks will likely have slow growth in the future; the CAGR of new account openings between 2022 and 2026 will be less than 1%. [6]

### US Neobank Account Holders and Penetration, 2019-2026

millions and % of population



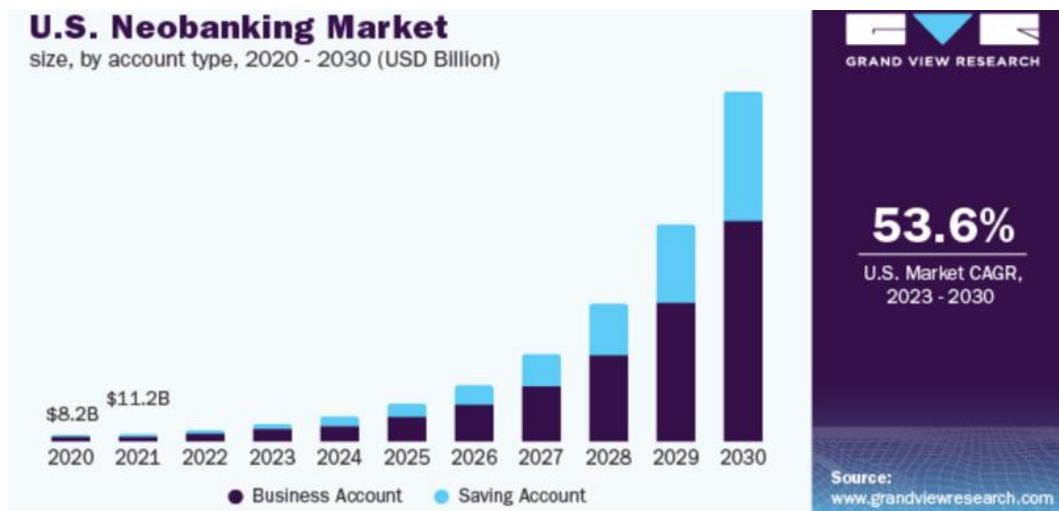
Source: Insider Intelligence, June 2022

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InsiderIntelligence.com

[6]

Between now and 2030, some consultancies, including Grandview Research, predict exponential growth.



[7]

Neobanks frequently depend on joint ventures with other financial institutions or traditional banks to offer specific services (such as payment system access or deposit insurance). Their biggest vulnerability may be this dependence, which raises concerns about the reliability of the services. Additionally, it usually results in neobanks offering a smaller selection of products. [7]

The four main criteria that most customers use to select their financial services providers are convenience, costs, security, and privacy. It should come as no surprise that the latter two in particular are responsible for the notable transition to digital banking. Customers choose digital - only banks because of their clear - cut, affordable, easy - to - use, and uncomplicated services. 61% of those surveyed said they would be interested in switching to digital - only providers for their main account. [8]

All types of users see prepaid cards, standalone digital accounts, digital - only accounts, and traditional accounts as good ways to store money. They use those accounts for a variety of purposes, ranging from online shopping and cash withdrawals to bill payment and payment processing. Even some customers employ digital solutions that are stand - alone as savings accounts. If their banks don't have built - in bucketing choices, customers also establish spending "envelopes" for various purposes across account types. [8]

While many customers say they are considering moving to a bank that only accepts digital payments, this major change is not inevitable. Only 18% chose to switch in 2020—in spite of the COVID - 19 pandemic - era obstacles that prevented them from visiting physical branches. This implies that if traditional providers give priority to digital growth, they will have an opportunity to retain their clientele. [8]

#### 4. Solutions

To address challenges, neobanks should prioritize transparency and security to build client trust. They must highlight robust security measures and regulatory compliance, while offering exceptional customer support.

Neobanks should differentiate themselves from traditional banks by focusing on unique digital experiences, niche markets, and innovative products. Reducing dependence on partnerships by developing in - house capabilities and diversifying offerings is crucial. Educational initiatives can ease consumer transition to digital banking, emphasizing convenience and security. Continuous innovation, compliance, and customer - centric approaches will sustain neobanks amidst competition and regulatory complexities.

#### 5. Conclusion

In conclusion, the rise of neobanks represents a significant disruption in the traditional banking landscape, fuelled by technological advancements and evolving consumer preferences. While neobanks face challenges such as building trust, competition from incumbents, and regulatory compliance, they also possess opportunities for growth and innovation. By prioritizing transparency, security, and customer - centric approaches, neobanks can overcome obstacles and continue to thrive in the financial industry. As digital banking becomes increasingly prevalent, neobanks have the potential to reshape the future of banking, offering accessible, innovative, and personalized financial services to a diverse range of consumers.

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