

Digital Disruption of Neo Banks with Reference to Indian Banking Landscape

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ABSTRACT

Neo banks offer financial products via digital means and provide banking services without a branch network. Neo banks by dint of fin tech have plugged into the conventional bank's network and become customer-facing banking service providers through their pecuniary innovations. They have also leveraged technology and artificial intelligence to offer personalized services to customers while minimizing operating costs. Moored by regulatory hurdles, neo banks are yet to unleash their true force. It is how we perceive this without any major economic strains in the banking arena will determine the success or failure in embracing the same.

This paper examines how the banking landscape will get more intricate by the initiation of Fin tech, in tandem with the growth of Neo banks, and its potential influences on the current situation of lending in the Public and Private sector. This study also proposes to critically examine the threats and opportunities in sustaining such innovations and enduring the same to progress in the Banking sector.

Keywords: Banking Landscape, Fin tech, Neo bank and Digital disruptions.

Introduction:

Banking as an industry is always considered as an important sector for the economic growth of any country irrespective of size and geography. The past few years have seen the fintech revolution commanding the Banking Sector, with many of fintech companies popping up. Indian Banking landscape is not isolated with these changes in the Banking sector. Additionally, the COVID-19 pandemic has also accelerated the transformation of banking. It created an opportunity to innovate, and almost all traditional banks supplemented their physical banking activities with sophisticated digital versions of their services. Banks expanded their digital footprints and are using their digital channels to offer a range of services. Hand in hand the rising consumer demand has also complemented the adoption of this technology in the banking sector. Globally, India has the 2nd largest base of internet subscribers, smartphones, and social media user base. This growth has been enabled by India's public digital infrastructure, rules, regulations and well drafted policies.

Neo banks are financial institutions with only an online presence and function digitally. They offer all traditional bank services through a digital setup or a mobile app without having any physical branches. Neo banks can be categorized into three types namely: Non-Licensed Fintech that partners with traditional banks. Traditional banks with their digital-only initiative and Neo Banks with digital banking licenses. This is possible in countries that permit stand-alone digital entities. They mainly cater to the

financial needs of the tech-savvy generation for immediate money transfers, lending, payments, etc. However, it is essential to note that these neo banks may not necessarily have their banking license but rely on their banking partners who offer financial services and products. These are 100% digital banks. And since the RBI does not allow 100% digital banking operations, they cannot apply for a banking license. In the recent years, Neo banks have constituted a significant part of these fintech companies disrupting the conventional banking ecosystem worldwide. These financial institutions are bridging the gap that exists in the conventional banking system by offering tech-first solutions. Riding on the success of the Indian Fintech stack- Digi locker, Aadhar, UPI 2.0, Account aggregator model, etc., neo-banks will be able to improve digital distribution channels and on boarding for retail customers and MSME's where the transaction base is increasing faster. The expertise of these neo banks lies in tying technology and artificial intelligence together to offer personalized financial services to customers. Currently, Neo-banking in India is at a nascent stage where some positive developments have been witnessed in the recent past.

Disruptions in Banking Sector:

Drivers of technology in Indian Banking Industry- Evolution of NEO BANKS:

The neo banking wave is sweeping all countries and continents, from the EMEA to South America. The term coined in 2017 means a new type of financial institution offering state-of-the-art, quick and flexible services directly available via a smartphone or messengers. The growth of neo banks peaked during the global anti-COVID quarantine. Neo Banking firms originated around five years ago, mainly in the United Kingdom by FinTech players such as Monzo and Atom Bank. Neo Banks also grew in Australia, with not just the implementation of crowd funding money, but legislation that removes constraints on the company being brought forward. In India, Niyo Solutions was one of the first companies to emerge in this sector. During the pandemic, the Indian Neo banking market expanded with the growth rate of 100% from FY'17 to FY'22, and registered a CAGR of 136% based on the value of transactions in between FY'17 and FY'21.

Gone are the days when people stood in the long ATM queues and bank queues to withdraw cash and opening bank accounts physically. Most banks now offer their own digital application. The digitization of money, COVID- 19 outbreak, fintech breakthroughs, digital trust etc., are major reasons that have enabled a cashless economy.

Some of the major factors contributing Digital growth through neo banks in Indian Banking Landscape:

Financial Inclusion: Indian policy-makers have conceptualised financial inclusion in terms of a three-part strategy based on using digital technologies: JAM, standing for Jan Dhan (banking), Aadhaar (biometric identity) and Mobile (transactions).

Increase in Digital Transactions: Promotion of digital payments ecosystem has been an essential aspect of Digital India programme and is aimed at digitizing the financial sector and economy with consequent benefits of efficiency, transparency and quality. Over the years, digital payment transactions and usage of financial technology by Indian banks have increased manifold in the recent years

Demographic Dividend: India's demographic dividend in terms of youth population is a key factor that is expected to propel the growth of digital banking arena. India has the largest generation of millennials in the world. A lot of millennials and corporates have opted for this newly-driven technology because it

offers ease of operation and excellent user experience through a digital platform. The target consumers of a neo bank are millennials who prefer operating and managing their financial budgets online.

Cost-Effectiveness: The absence of physical branches reduces significant overhead charges. This enables Neo banks to reduce the prices of their services and offer higher interest on deposits and also driving revenue growth by quickly reaching underserved customer segments and launching new products.

Personalised Services: Neo-banks provide personalised services powered by technology to their customers because they are customer-focused. A neo-bank makes decisions using data as the primary factor. Due to the advanced nature of their platforms, they are better able to monitor and analyse customer activity in the neo-banking system.

Competition from New Entrants: A sharp rise in the Payment banks and Fintech companies have made the existing banks to be agile and acquire new technologies to introduce new approaches to serve the customers. Banks are busy with continuous innovation and product designing supported by new processes to retain their customers. Banks have implemented digital banking platforms to capture the valuable information about the customers. Augmented by changing consumer behaviour and Fintech-friendly government initiatives, e-commerce giants also have started penetrating the Indian financial sector permeating digital innovations in various dimensions of customer services.

Analytics: Customer analytics in the banking industry makes the services more customer-centric and organized hence, increases the overall efficiency of the system. With neo banks, customer analytics is easier as the data is completely cloud-based. Therefore, from fetching the data to processing it, analysis becomes easier and accurate. Neo banks are slowly taking the banking sector to the next level with multiple advantages like faster customer onboarding, 24/7 customer support, budget-friendly services, etc. With customer analytics, neo banks helps to enhance customer relationship.

COVID-19: Neo banking has exponentially grown during the Covid-19 pandemic. The social distancing norms during the pandemic has pushed customers to embrace digital banking instead of conventional banking to fulfil their financial needs. The pandemic has brought neo banks to the same level as traditional banks as the services of both have majorly relied on apps or websites during the pandemic. This has pretty much made the people aware of the benefits of digital banking, and it will continue to instigate people to move towards neo banking to shape their financial space.

Digital trust: An imposing building and presence over decades were equated with solid performance and trust by the older generation. Millennials and Gen Z don't see such as markers of trust. They expect the digital experience to work best for them. Digital-only banks maybe even more secure, as their livelihood depends on their security measures and more so over neo banks are only digital, so they have to put a lot of ingenuity and resources into making their apps stand out.

Regulatory vacuum: There is a common misconception that neo banks operate in a regulatory vacuum. Banks are required to adhere to and impose stringent outsourcing obligations when partnering with neo banks. Requirements include continuous monitoring, data security and grievance redressal obligations, and regular audits. The RBI also has the right to access neo banks' accounts and transaction records. This is another fuelling factor for the growth of neo banks.

REGULATORY ARCHITECTURE OF NEO BANKS:

Technology and the internet have revolutionized industries in ways that would have been unimaginable a decade ago – and now they have come for banks. Many neo banks offer features such as instant account opening, AI driven insights into spending, and payroll management – essentially solving for inefficiencies

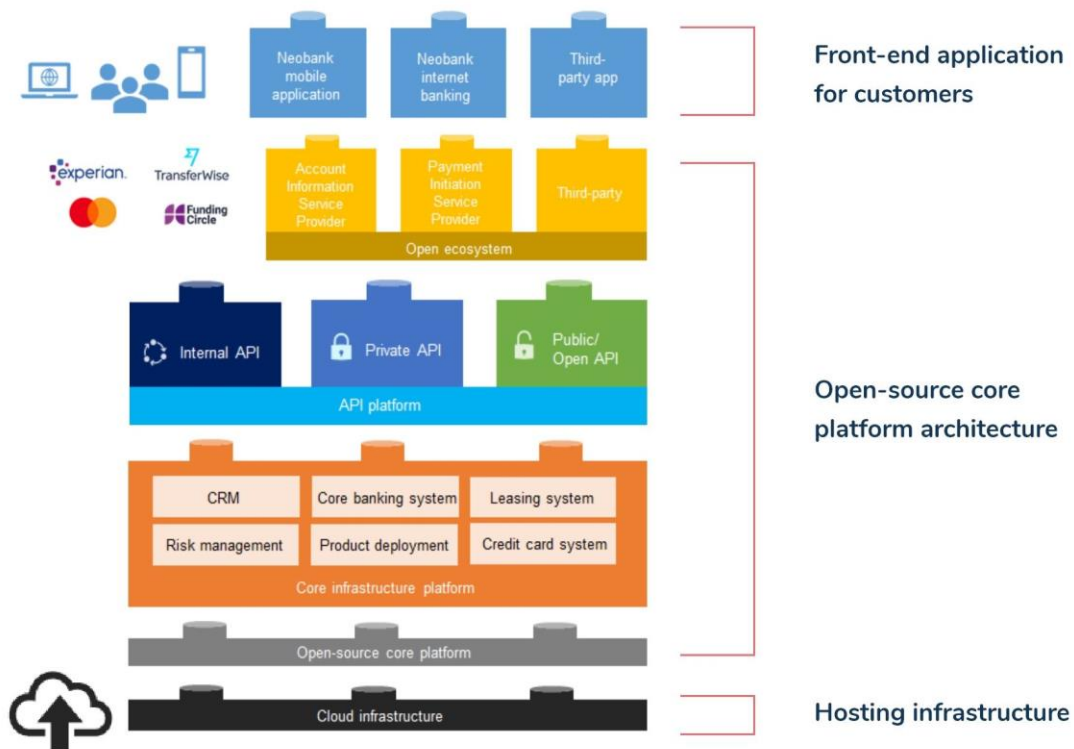
and making banking more convenient. Unlike traditional banks, which are authorised and regulated by the Reserve Bank of India (“RBI”) – neo banks are not directly regulated. Neo banks operate by tying up with regulated banks to offer over the top services, on top of their partner banks’ regular banking services.

Three layers of tech stack in a neo bank:

Hosting Infrastructure: A hybrid cloud set-up allows neo banks to store and operate in the public cloud for third-party integration and the private cloud to store and develop its services.

Open – source core platform: Most of the neo banks are built on scalable applications that help them to build seamless front end user experience. A key reason for the success of a neo bank is a robust platform for handling large amount of transactions and function without interruption.

Front end application for user: Customer experience is the key to success of any service industry. Disruptive fin tech like AI, biometrics, VR, AR and quantum computing act as key drivers for the efficiency in untapped business segments.



Source: Twimbit Analysis

COMPARITIVE STRENGTHS:

Simple Account-Opening Procedure:

Even though the procedure to open a traditional bank account is less complex than before, there is enough paperwork and form filling required to open a bank account, and some banks even ask the customers to visit the nearest bank branch to open a deposit account. With neo-banks, the process is hassle-free and there is no question of customers visiting any branch to open an account, as it doesn’t exist. The account can be opened on a mobile phone through an application in a short span of time.

Simple and User-Friendly Interface: With superior technologies, neo-banks provide a delightful customer experience. The applications and websites are very responsive, unlike that of the traditional

banks where the net-banking websites are often filled with glitches and the mobile applications lag many times.

Comparatively High return on Savings:

One of the biggest advantages of neo banking is the higher interest rates for saving accounts. The average neo bank interest rates range from 0.5% to 2.5%. This is much higher than traditional banks, which typically offer an interest rate of 0.0% to 0.2%.

Round the clock Support:

A neo bank account can be opened and accessed with services that are available around the clock without having to visit a branch, all services are accessible digitally and so they are available at all times.

Low Operational Costs:

Since neo banks operate exclusively online, they have very low operational costs, allowing them to charge lower fees and offer higher interest rates on checking and savings accounts.

Quick Customer Services:

Since everything is online, customers can get quick customer services, support through digital channels and dedicated phone lines. From their homes/ offices consumers especially the millennial generation who are tech savvy as well as the corporate segment- MSME sector can access all financial products and services 24/7, eliminating the need for physical visits to branches.

Less Pain Points:

Both the banker and the customer needs are met by saving time waiting in long queues, managing customers at branches. Hence low pain points both to the banker as well as customer.

International payments:

Traditional banks require you to have specific upgrades to carry out a transaction using a debit card. Neo banks offer the advantage of one card for all payments. Instant international payments can be carried out with a single card or even without a physical card.

ISSUES:

No branch network: One disadvantage is that most of the Neo banks are completely digital banks and therefore does not have a branch network. In this respect, branch banks are better. Hence no direct contact person for the Neo bank checking account in any case.

Confidence: This is more of a problem with older customers –especially the Generation X, they basically don't trust new technologies, which is why they prefer to rely on the old-fashioned systems instead. The particular problem is that this prejudice means that many people do not even bother with the new possibilities, even if they would ultimately be advantageous.

Security: There are still minor to major scandals from time to time, which damage the public image of neo banks. With reference to this area, traditional banks still feel much safer.

Limited Services: Neo banks offer most of their services through a partnering bank. They do not offer non-banking services and hence, they are not preferred by customers who require a complete banking experience.

Regulatory hurdles: Neo banks are less regulated than traditional banks. In some cases, neo banks may not be fully chartered or licensed, which can pose issues in the event a neo bank goes bankrupt, potentially leaving the security of your money in jeopardy.

Dependence on other financial institutions- Some fin-techs have a non-banking financial company (NBFC) as their parent to engage in lending activities while most others partner with banks and financial institutions.

CONCLUSION:

Neo banks are said to be the future of banking not only in India but across the globe. The Neo banking sector is expected to grow at a CAGR of 53.4% between 2022 and 2030 which is unprecedented growth for any sector. These numbers only suggest that neo-banks have a great potential to grow in India, however, it is also important to understand the approach of neo-banks towards managing the hindrance concerning regulatory norms, data security, and API integration.

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