Neo-Banks Vs Traditional Banking

Why in news?

The Neo-banks are changing the face of fin-tech by bridging the gap between the services that traditional banks offer and the evolving expectations of customers in the digital age.

What are Neo-banks?

- Neo-banks are **online-only** financial technology (fin-tech) companies that operate solely digitally or via mobile apps.
- Neo-banks are digital banks without any physical branches offering services that traditional banks don't.
- In India, these firms **don't have a bank licence of their own**, but rely on bank partners to offer licensed services as the RBI doesn't allow banks to be 100% digital yet (though some foreign banks offer digital-only products through their local units).

How are they different from other types of banks?

- **Neo-bank vs Traditional bank**- Neo-banks leverage technology and artificial intelligence (AI) to offer a range of personalised services to customers while traditional banks follow an omni-channel approach through both physical (branches and ATMs) and digital banking presence.
- While neo-banks don't have the funds or customer base to overthrow traditional banks, they are powered by innovation to launch features and develop partnerships to serve their customers more quickly than traditional banks.
- Neo-banks cater to retail customers, and small and medium businesses, which are generally underserved by traditional banks.
- Venture capital and private equity investors have been keeping a keen eye on the market opportunities for such banks and are taking an increasing interest in them over traditional banks.
- **Neo-bank vs Digital bank-** A digital bank and a neo-bank aren't quite the same.
- Digital banks are often the online-only subsidiary of an established and regulated player in the banking sector while neo-banks exist solely online without any physical branches independently or in partnership with

traditional banks.



How are the neo-banks evolving?

- The term 'Neo-bank' started gaining prominence globally in 2017.
- Neobanks are also called '**challenger banks'** as they emerged as a new challenger to the traditional banks in terms of customer engagement, connectivity and reach, and the user experience.
- Although neo-banks is a relatively new concept in India, the concept has been gaining traction over the last few years.
- India's neo-bank startups raised more than $230 million in 2020, according to a report by a fin-tech research firm.
- There are around a dozen neo-banks in India including Razorpay X, EpiFi, Open, NiYo, Jupiter among others.

What are the pros of neo-banks?

- **Low costs -** Fewer regulations and the absence of credit risk allow neo-banks to keep their costs low.
- Products are typically inexpensive, with no monthly maintenance fees.
- **Convenience** - These banks offer customers the majority (if not all) of banking services through an app.
- **Speed** - Neo-banks allow customers to set up accounts quickly and process requests speedily.
- Those that offer loans may skip the usual time-consuming application processes in favour of innovative strategies for evaluating the credit.

What are the challenges that they face?

- **Digital illiteracy** - Since neo-banks are highly digital-focused, they may not be able to cater to the banking needs of non-tech-savvy consumers or people from the rural parts of India.
- **Mobile penetration** - As of 2020, India had a smartphone penetration rate of just about 54% which will exclude the rest of the people from neo banks purview.
- **Services offered** - Neo-banks offer only a small range of products and services as compared to a whole gamut of services that traditional banks offer.
- **Building trust** - Unlike traditional banks, neo-banks don't have a physical presence, so customers cannot literally bank upon them in case of any issues/challenges.
- Hence, models such as freemium subscriptions and memberships are

common in neo-banking in India, as they allow customers to experience the service before paying for it.

- **Regulatory hurdles** - Neo-banks are yet to be recognized by the RBI.
- Due to the absence of enabling regulations, neo-banks cannot accept deposits or offer lending products on their own books.
- **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.
- Hence, neo-banks can complement traditional banks but cannot replace them.

References

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