NEO BANKING AS DISRUPTIVE INNOVATION TO INDIAN BANKING SECTOR

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Abstract

The role of banking system plays a vital role in developing nations like India. In today's era banks not only keep deposits and lend money, but also they perform thousands of other functions to meet customers rising expectations. The paper develops an understanding of Fintech via the emergence of Neo-Banking as an innovation and describes its prospect for the Indian Banking Sector. Neo banks offer a current account, saving account and all other banking services just like traditional banking but completely digital at reduced costs, and a user-friendly interface. The objective is to analyse the neo-bank acting as a disruption to legacy banks and to study the prospects of Fintech in the banking sector. A descriptive research design has been followed with secondary data collected from reputed journals, banks' audited balance sheets, etc. The study further explains the functionalities and regulations related to neo-banks. This paper revealed that neo bank being a Fintech disruption is gaining importance in the financial industry as neo bank is trying to become the bridge between customers and traditional banks such that it gives rise to Banking as a service (BaaS).

Keywords: *Neo bank, Artificial intelligence, Emerging Technologies, B2B/ B2C model, Fintech Disruption.*

1. Introduction

Post pandemic has changed the way people work and operate, and this transformation has triggered disruptions across different sectors. One sector that is responding to these changes is the banking sector. Traditional banks have to adapt to the new banking era demanding customer engagement. Moreover, there is stiff competition from Fintech players that is disrupting the entire banking sector. Traditional banks follow an Omni channel method i.e., having both physical branches, offices and ATMs and digital banking presence to offer a bundle of services. Reepu (2023) in his research paper mentioned neo banks as a disruption in the banking industry by leveraging high-end technology which provides a range of personalised services to customers resulting in client happiness, transparency, responsiveness and ease of use. Neo bank applies a creative design thinking approach to particular banking operations and custom tailors their products and services in such a manner that makes banking simple and convenient to use by customers (Bradfort, 2020). As this a challenge for them to make banking simple and convenient, they are sometimes referred to as challenger banks. They are changing the work processes of traditional banks and bringing disruption to the banking era. Due to increasing digitalisation and the impact of the pandemic, banks are failing to match customer expectations. Evolving customer requirements have given rise to a new class of banks called neo-banks.

As per Gundaniya (2021), Neo banks in other words are a financial technological company operating via online mode digitally or through mobile application. In other words, no bank is a digital bank without any physical branches. Traditional brick-and-mortar bank business models have become obsolete under the pressure of technological innovations in the banking era (Temelkov, 2020). Neo bank is emerging as a challenge in front of traditional banks in terms of strong customer engagement, improved connectivity and reach and personalised user experience. That is why it is also commonly known as a challenger bank. They are not allowed to provide any banking services independently as per the Reserve Bank of India.

Table 1: Difference between Traditional Bank and Neo Bank

Points of difference	Traditional bank	Neo bank
Commonly known as	Legacy bank or brick-and-mortar bank	Challenger bank or phygital bank
Cost	High	Low
Process time	Long	Less and quick decisions
License	Banking license issued by RBI	No license issued by any apex body
Personalised services	Standardised services	Bundle of personalised offering
Service platform	Physical branches	Online workspace
Customer support	In-person, phone, online	Phone, online
Fees	High	Low
Generation preference	Gen X Senior citizen	Millennials Gen Z
Operation mode	Independent	In partnership with traditional banks

Source: https://softensy.com/what-is-a-neobank-and-how-does-it-differ-from-traditional-banking/

Countries like the United States and Australia have given license to their neo-banks whereas developing countries like India has not given licence to the neo-banks. They can collaborate with commercial banks to provide better adaptable solutions across various diverse business segments with the use of high-end technology like artificial intelligence, machine learning, data science, API, open banking, etc (Gundaniya, 2021). The integrated partnership creates value as a neo-bank handles the technology and innovation part while the traditional bank handles trust, risk and collections. The advantage of the low cost of operations provided by Neo Bank results in better offerings and promotes customer loyalty (Cherednychenko, 2020). As a result of the partnership, a seamless and integrated customer experience is created while managing their financing and business banking needs (Shaji, 2020). This can be achieved through an integrated platform for automated transaction payments, tax compliances, accounting services, investment needs analysis, account opening etc. As neo bank offers cutting-edge technology they take care of crucial data and its analysis whereas commercial bank act as currency custodian. A new term has also been coined on this collaboration which is Phygital which means Phy – which means physical branches network where banks maintain and grow their business Gital – the bank may expand their business through digital offerings. As per Gonçalves (2020), phygital is the combination of online and offline customer experiences. Presently Neo Bank cannot operate independently. In future, they may be allowed to operate independently as in developed nations.

2. Literature Review

Koibichuk et al. (2021) describe the efficiency and potential technological change in the banking sector conducted the study in 90 countries focusing on the level of risk and cyber frauds based on Neo-Banking using the gravitational model. The overall study uses four factors supply conditions, demand conditions, institutional environment and Innovation & change with a total of 13 components subdivided among four factors. The study uses gravitational force to estimate the level of risk in money laundering concerning neo-banking. The study concluded that using Neo-banking as an innovation to the banking system, the risk of fraud reduces showing that approx. 37% of countries have no risk, 25% of countries experienced a low degree of risk and the same proportion agree to medium level risk (PwC, 2021). Only 12.2% of countries seems innovation as a high level of risk which too may be due to their poor IT infrastructure. Shettar's (2020) paper emphasized a characteristic of neo-banks, major players and funding for European and US neo-banks to streamline the landscape of the banking sector. The paper used secondary sources for data collection and concluded that the neo banks give tough competition to traditional banks concerning reduced cost, time-saving, customization features, and user-friendly.

Pius and Velmurugan (2021) highlighted the growth and operational mechanism of Neo banks in the context of Indian society. The study considered Finin as the first neo-bank start-up based in Bengaluru to partner with the State Bank of Mauritius. The study concluded that India has a higher growth rate of 33.33% than the global growth rate of 16.06% during 2019-2020 in comparison to the negative growth rate of 8.18% for traditional banks in India. Studies revealed that banks use Application Programme Interface (API) to provide a complete package of digital services to their customers becomes the finest characteristic of neo-banks (OECD, 2020). Agrawal and Yesugade's (2022) objective is to understand and compare the net banking and neo-banking services along with awareness among the public about neo-banks. The study used exploratory research with convenience sampling for a sample size of 55 via a structured questionnaire. The study concluded that mobile wallets and net banking are mostly used by customers but are ready to shift over neo banks if awareness increases. Wewege et al., (2020) emphasize updates in the Fintech industry to count down the significant growth and development across the globe. The paper focused on banks becoming challenger bank institutes and now inclined towards completely digitalised banks adopting the API technology. The banks initially modernise themselves for self-reliance concerning data sharing and protection, cyber security, and stability. But later on, doors opened to become customer-centric banks by providing technologically enhanced services to customers under the same umbrella widening the scope of the Fintech revolution.

The study by Shabu and Vasanthagopal (2022) identifies the challenges and opportunities of neo-banking concerning the Indian customer perspective by using content analysis of 1730 tweets using Nvivo software. The study reveals the positive outcome from customers about the emergence of neo-banks and their consideration to use neo-banking services. The opportunities identified are hassle-free access, zero overseas ATM charges, and free-of-cost overseas transfer and challenges become lack of personal interaction, fear of safety and limited access to financial products. Dokania (2020) talks about the reconstruction of traditional banks into neo-banks and their regulations in India along with a performance comparison of neo-banks in India with other countries. The regulation of neo banks was initially restricted by RBI considering a threat to an ecosystem like cryptocurrency, but later in 2019 allowed to feature in India with established banks as its partner. Five neo banks recognized during the study includes NiYO, 811 by Kotak, OPEN, YONO by SBI and InstantPay providing techno-savvy services to their customers concerning zero ATM fees, higher interest on saving account and no to forex card. Finally, concluded that neo-banks are the new age of the banking sector providing seamless customer services eco-friendly (Srinivasan & Karanam, 2019). Another study by Kangas (2019) also investigated about growth and future of neo-banks in Indian banking domains using secondary data and has confirmed that neo-banks possess higher growth prospects as they rightly hit the gap between traditional banks and customer requirements. Filling this gap through the easy process of account handling, lower charges transactions, and removal of foreign transaction limits makes it better in terms of other banks. Another study conducted by Dongare et al (2022) tries to reveal the role of Fintech in the Indian banking system attached to its challenges after the Fintech era. The banking industry can benefit from the Fintech revolution concerning employee engagement, higher productivity, and internal operational control (Visalakshmi & Rasiah 2017). Fintech building a diverse model and agile in the upliftment of the banking domain frequently improving the financial services. The challenges comprise of lack of financial literacy, data security encryption and some consumer protection regulations.

3. Research Methodology

3.1 Objectives of the Study

The main objectives of the study are:

1. To examine the evolution of Neo banking as a disruption to the Legacy Banking in India.
2. To study the trend of Fintech concerning the Banking sector of India.

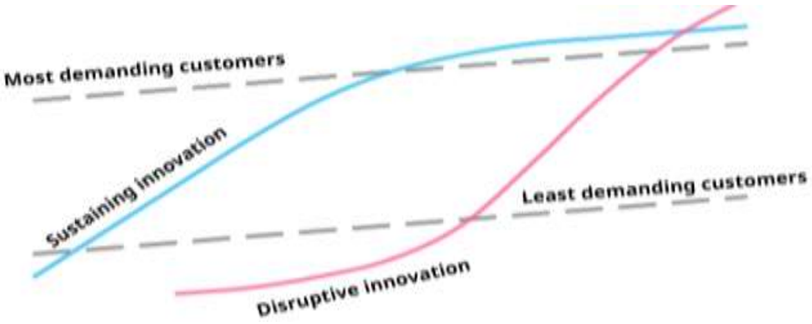
3.2 Research design The paper is based on Descriptive research using qualitative data collected from different secondary sources and published journals to identify the emergence of Neo Banks. This paper comprises two models i.e., the first one is to describe neo banking has similar characteristics to disruptive innovation and the second describes the strategic partnership between legacy banks and neo banks enhancing the banking system with change adoption to economic development.

4.0 Discussion and Analysis

This section conveys how the banking sector taking a different shape regarding service providers and technology adaptation. Figure 1 showcases the incumbent sustaining innovation that is something which significantly improves the existing market aims to sustain the position likewise the Legacy banks continuously thrive for updates concerning technological advancement, strong customer-dealing and trust building in the existing market

(Roblek, 2021). Though traditional banks aim to provide services to every customer segment targeted to big customers, corporate houses view to make high profits in a settled marketplace. Their improvement emergence to digitalized services but not a hundred per cent which becomes an innovative gap (Shabu & Vasanthagoal, 2022). Here comes the role of Neo banking disrupting the Fintech industry and targeting small businesses to reap their success through complete digital services without the existence of a physical place. Therefore, disruptive innovation as neo banks upholds the gap between innovation and target customers providing prospects to enter the niche market offering fully digitalised services to small players which often becomes a challenge to the incumbents as well.

Figure 1: Disruptive Innovation

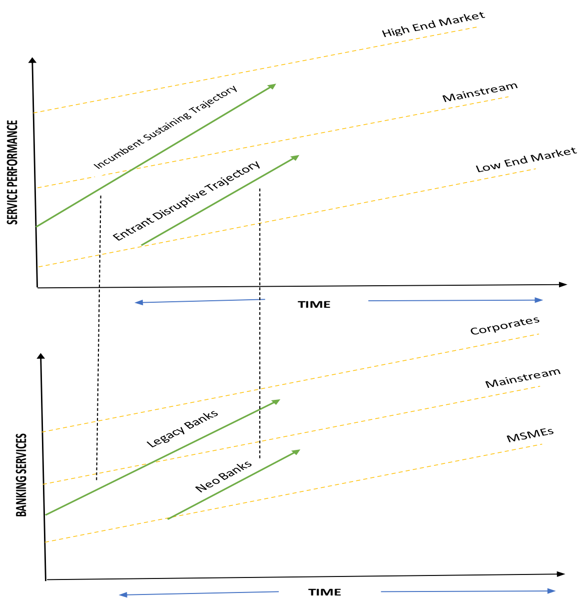


Source: https://images.app.goo.gl/MS9KvPgyKiMfDDsN7

4.1 Disruptive Neo Banking Model

The model relates banking services (or service performance) on Y axis with Time on X-axis to showcase the evolution in the banking sector. The model depicts three different phases High-end market, mainstream and low-end market.

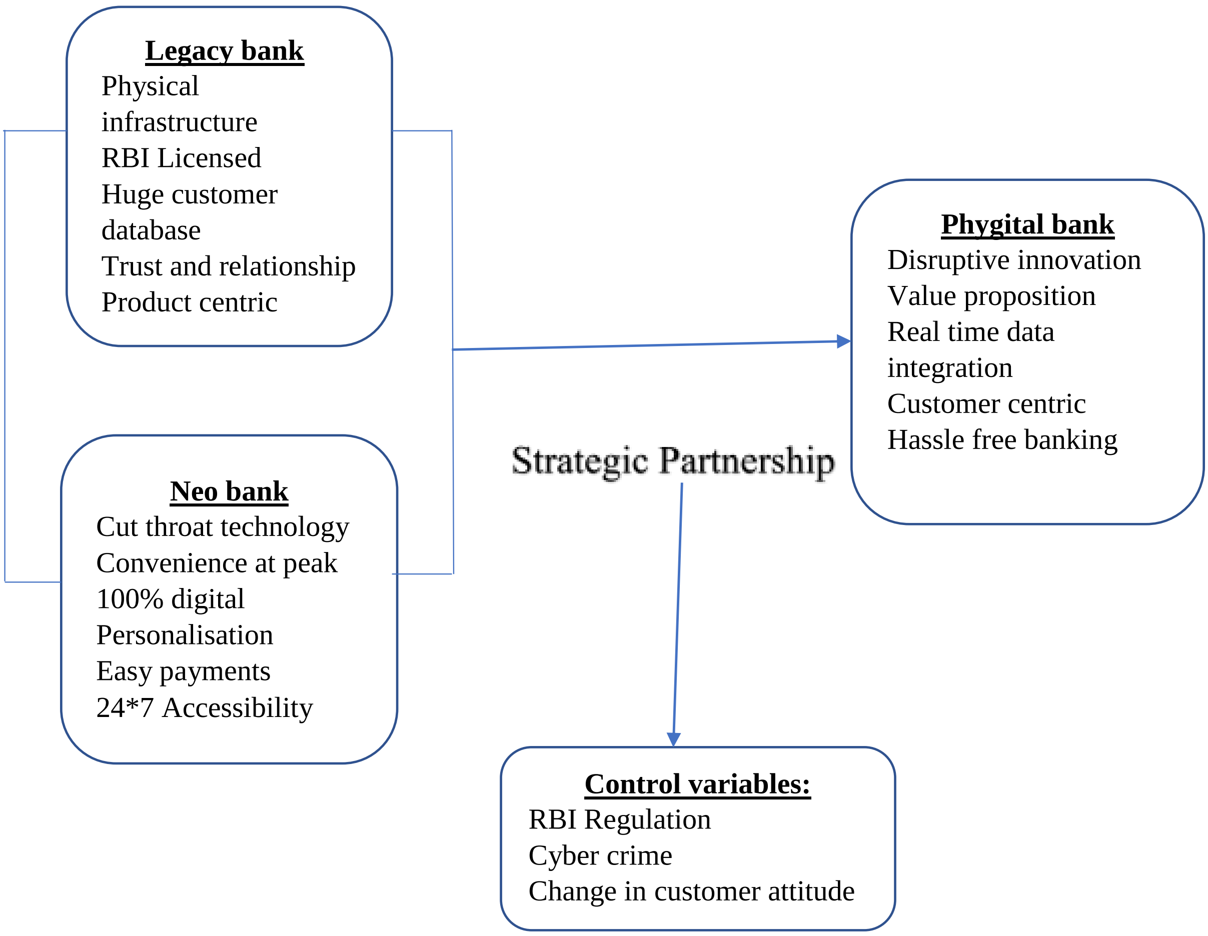
Figure 2: Disruptive Neo Banking Model



Source – Author's Own

The high-end market indicates more demanding customers like big corporates prefers to be performance choosers and price takers Mainstream is where some customers are looking for different services and the Low-end market indicates fewer demanding customers like MSMEs likely to be the price choosers and performance taker (Kumaraswamy *et. al* 2018). Figure 2 states that the legacy banks as incumbents ignoring the need for downmarket likely not to respond to new entrants but rather focus on their improvement to serve better high-end customers acting like a sustaining trajectory. Whereas, the Neo banks in their introductory stage provide personalisation schemes, easy payments, and 24*7 Accessibility stand with cutthroat technology Kangas (2019). Neo banks currently working in the Low-end market and are yet to enter into the mainstream segment in India as its emergence is not completely revived still its trajectory is upward (Christensen, *et.al* 2018). The reason for the statement is also Reserve Bank of India has not approved neo-banks as licensed banks, yet working as partnered banks. By way of discussion, the viewpoint is to build new banks as an entrant disruptive trajectory.

Figure 3: Conceptual Model of Neo Banking as a New Eco-System



Source: Author's Own

In the second attempt, the paper tries to develop a conceptual model comprising the characteristics of legacy bank and neo bank to formalize Phygital bank. As per Maryna (2021), Traditional banks mostly follow *the legacy banking system* which is primarily product-centric. It has a huge customer database due to a high level of trust and strong bond between banker and customer. It is highly regulated and follows all rules and regulations described by the Reserve Bank of India. Legacy Bank also tries to reform itself by adopting digital infrastructure but presently facing challenges such as massive digital platforms handling online risks and frauds happening to customers in large numbers. Nowadays customers want everything as per their needs and requirements and that too on an immediate basis. They demand easy and quick modes of transfer of payments having real-time access to data and information. All these things have been offered by neo-banks (Gundaniya, 2021). A *phygital banking* platform enables a bank to bring together the advantages of existing processes along with novel digital products and services offered by neo banks that are critical in attracting niche customers but also retaining your market share in today’s increasingly competitive financial markets. In this new phygital bank platform, the bank is in a position to deliver new innovative services and products in an agile and flexible manner (Gonçalves, 2020). The consumer spectrum of a bank is transforming itself to fintech. Phygital banks provide connectivity between customers and providers as a result of which a high-value proposition is developed and disruptive innovation has taken place. Digital hassle-free and also customer-centric banking services can be offered (Shaji, 2020). A few control variables which play a significant role in mediating a role of creation of a new bank ecosystem can be RBI Licensing, exponentially increasing cybercrimes and change in customer attitude and opinion.

4.3 Growth Prospect of Neo Banking amid 2021-2030

Table 1 showcases that the neo-banking market is expected to grow at a three-year CAGR of 53.4% to reach USD 2048.53 billion by FY2030. Neo banks are in their nascent stage and still will compete with traditional banks faster based on the proposed growth rate. It is anticipated that neo banks sooner become a tough competition to traditional banking impacting the economy's growth and development. The values are forecasted in US dollars considering the base year as 2021 within the scope of Japan, China, Germany and India. According to statistics, the global neo market size is $47.39 billion in FY2021 and is estimated to grow at a CAGR of 53.40% from FY2022 to FY 2030. The study investigates that Neo-banking acts as a disruptive innovation in the banking system concerning user customization, ease of operation and advanced functions for retail as well as a business customer segment. Mostly MSMEs adopt neo-banking in practice to compete and gain technological advantage allowing accounting software to easily access loans and deposits with one click.

Table 2: Market scope of Neo-banking

Components	Details (in Billion $)
Consider as Base Year	2021
In 2022, the market valuation	$66.82 B
By 2030, the revenue forecasted	$2,048.53 B
Forecasted Growth rate	53.4% as CAGR From 2022 to 2030
Report covered	Revenue forecast, Company market share, Competitiveness space, growth rate and trends
Divisions covered	Accounts, Application, Region

Source: https://www.grandviewresearch.com/industry-analysis/neobanking-market

Conclusion

The papers create a similarity index of disruptive innovation and neo-banking to affirm its development in the Indian banking sector. Neo banking representing the newer version of banking has a long way toward scalability despite the lesser customer base. Indian banks concerning digital onboarding have great scope to become neo banks or challenger banks. One of the challenges to new banks is the lack of significant funds as still they are in the low-end market stage but is overwhelmed by the advantage of cutting-edge technology which legacy bank lacks. In future, neo banks are expected to rise at an astronomical rate to compete with sustaining trajectory i.e., Legacy banks. The traditional banks also provide digital financial services but face online risk and frauds which break down the customer's trust looking for a more refined and trusted platform where the customer can even customize their services. The opportunity is grasped by the concept of neo banks ensuring safety as a priority along with complete digital financial services. The growth of neo banks targeted 53.4% CAGR till 2030 which can disrupt the whole banking sector and also by that time can enter the mainstream market.

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