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Neo-Banks in India -Challenges and Expansion in Future

Mrs. Sushma Rao K
Research Scholar, DOSR in Commerce
Tumkur University, Tumkur

Dr. Suresh B K
Chairman, M Com (IS)
Tumkur University, Tumkur

Abstract
The Indian banking sector has undergone substantial changes in terms of market dynamics and competition driven by technological and digital innovations. The integration of fintech has enabled the delivery of tailored, user-friendly solutions for customers. One of the most groundbreaking strategies within the fintech sector is neo banking. Although relatively new to the broader fintech landscape, neo-banks have made considerable strides and grown rapidly in India. These are entirely online, branchless financial institutions that emphasize speed, innovation, and customer-centric services. In contrast to traditional banks, which are known for their physical presence and bureaucratic procedures, neo-banks operate independently and frequently partner with fintech firms to utilize cutting-edge technologies such as artificial intelligence, machine learning, and blockchain.
Neo-banks have transformed the banking sector by bridging the gap between the services offered by conventional banks and the increasing demands of customers in the digital age. While neo-banks in India are still in their early stages, factors like widespread digital adoption, cost-efficiency, fintech collaboration, the rise in smartphone usage, and an increase in partnerships with traditional banks are creating a favorable environment for the growth of neo banking in India in the future. However, challenges such as cybersecurity risks, limited brand recognition, lack of customer loyalty, and regulatory hurdles may pose obstacles to its widespread adoption.
This study aims to examine the potential of neo banks in India by assessing their strengths, weaknesses, opportunities, and challenges, while predicting how they may be integrated into the future banking sector in India.
Key Words: *Neo Bank, Fintech, Traditional Banking, Digital Banking*

I. Introduction:

Indian banking has undergone significant transformations, particularly in terms of market dynamics and competitiveness, primarily driven by technological and digital advancements. Today, fintech integration has enabled the delivery of personalized, on-the-go solutions for customers. One of the most innovative approaches embraced by fintech companies is neo banking. Neo banks represent a new paradigm in banking, emerging from changing customer preferences and demands. The term "Neo bank" gained considerable attention in 2017 as fintech companies and digital financial service providers aimed to challenge the dominance of traditional banking systems. Although India already has neo banking startups and companies, they are still in the early stages of regulation.

Neo banking is a novel concept emerging in the Indian banking sector, operated entirely online using "Information Technology" and "Artificial Intelligence," without a physical presence. Neo banks are considered non-banking service providers because the Reserve Bank of India (RBI) has not permitted them to offer 100% online banking services. As a result, they must partner with traditional banks to provide their services.

Neo banks offer benefits such as fast account opening, cloud storage, seamless payments, transfers, remittance solutions, and more. They also provide creditworthiness solutions to attract MSMEs. In an era of digitalization, the rise of neo banks presents a significant opportunity for growth in the Indian market due to their "low-cost business model." However, the establishment of neo banks in India has faced challenges. In 2018, the RBI imposed a restriction on cryptocurrency trading, citing security concerns, which led to a temporary setback in the progress of neo banking in the country.

Objectives of the Study:
1. To understand the key concept and overview of neo banks in India.
2. To assess the strengths and weaknesses of neo banks compared to traditional banks.
3. To analyse the opportunities and threats for neo banks.
4. To evaluate the future of neo banks in India.

Research Methodology:

The research is carried out through an extensive literature review to gain insights into the evolution, growth, and potential challenges faced by neo banks. This study relies on secondary data sources, analysing information from a variety of e-sources, academic journals, books, industry reports, and regulatory documents to evaluate the present scenario and future outlook of neo banks in India.

Neo banks:

Neo banks are a unique type of digital bank. The term "neo bank" refers to fully virtual, digital, and internet-based banking institutions. These banks operate entirely online, without any physical branches, and collaborate with traditional banks to streamline customer acquisition. As fintech companies, neo banks function similarly to banks but rely entirely on digital platforms, such as financial apps, for their operations. All transactions, from account opening to other banking services, are conducted online, offering customers enhanced safety, personalization, and convenience compared to traditional banking. Neo banks challenge traditional banking practices like cash deposits, extensive paperwork, and face-to-face interactions with bank officials. The core objective of neo banking is to provide innovative financial services through fintech and AI at a lower cost.

Neo banks provide a wide range of digital financial services, such as mobile payments, money deposits, transfers, savings and investment management, loans, and more. Additionally, they offer access to trading markets, including stocks, commodities, and cryptocurrencies. One of the key advantages for customers is the affordability of services provided by neo banks.

Currently, there are about 400 neo banks serving nearly one billion customers worldwide. According to estimates from various accounting and analytics firms, neo banks could replace approximately 40% of traditional bank branches by 2032. In 2018, the global neo bank market was valued at USD 18.6 billion, with projections indicating rapid growth between 2019 and 2026, at a compound annual growth rate of around 46.5%. By 2026, the market is expected to reach USD 394.6 billion.

Overview of Neo Banks in India:

In India, traditional banks have started shifting to digital operations, but this transition is still in its early phases, while neo banks are already fully digital in their service offerings. According to a fintech report, India's neo bank startups raised over $230 million in 2020. Niyo Solutions was recognized as the first fintech company to explore neo banking in India in 2016. By 2024, several neo banks gained significant attention due to their innovative features, high customer satisfaction, and swift adoption. Below is a list of some of the top neo banks in India and their key features.

Name	Year Established	Key Features and Services	Target Audience	Key Partnerships
Niyo	2016	Digital savings accounts, Niyo Global (Forex), Niyo Money, expense tracking, personal finance insights	Individual, frequent travellers	Partnered with YES Bank and DCB Bank
RazorpayX	2018	Business account, invoicing, payroll, GST filing, seamless payment solutions	SMEs, startups	Partnered with IDFC First Bank
Open	2017	Business accounts, integrated accounting software, expense management, tax filing	SMEs, startups, entrepreneurs	Partnered with ICICI Bank
Finbox	2020	Personal finance management, credit score monitoring, flexible savings options, investment tracking	Individuals	Partnered with SBM Bank
Jupiter	2020	Smart savings, instant loans, joint accounts, zero balance requirements, automatic savings	Young professionals, students	Partnered with Federal Bank
Yelo	2020	Business accounts, no-fee transfers, customizable banking services, employee benefits	Startups, SMEs	Partnered with YES Bank
Zolve	2020	Global accounts, instant credit line, expense tracking, zero foreign transaction fees	NRI, travellers	Partnered with FinBox, Visa
Fampay	2020	Prepaid cards, allowance management, family-friendly features, child financial tools	Teens, parents, families	Partnered with RBL Bank

In India RBI is focused on prioritizing regulations and has not yet approved a fully digital bank model. Therefore, neobanks are not allowed to obtain a banking license by the RBI. At present neo banks have no choice other than collaborating with traditional banks. Although not directly regulated by RBI, neobanks in India have banking partners such as ICICI, HDFC, and other banks which are registered with RBI.

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Advantages of Neo Banks:

1. Simple Account Opening: Neo banks enable users to open accounts directly from their smartphones without the need for physical branch visits. Unlike traditional banks, no paperwork or in-person visits are required.
2. Fast Service Delivery: Thanks to automation, neo banks can quickly provide services like real-time accounting, balance sheet management, profit and loss statements, and tax-related services such as GST compliance.
3. Lower Costs Than Traditional Banks: As neo banks do not maintain physical branches, they can offer services at a lower cost. This cost-saving is passed on to customers, who benefit from no withdrawal fees or monthly/annual maintenance charges, making them more convenient than traditional banks.
4. High Security: Neo banks prioritize the security of customer data. They implement strict privacy, security, and safety protocols, as they do not rely on outdated technology. Their platforms are more secure due to their use of modern systems.
5. User-Friendly Interface: Neo banks leverage advanced technology to provide mobile apps and websites that make managing accounts easy. Customers can handle payments, view bank statements, and track financial transactions with convenience.
6. Transparency: Neo banks offer clear information regarding fees, charges, and penalties. Customers are notified in real-time about any costs incurred, ensuring no hidden fees or surprises.
7. Support for MSMEs: Neo banks streamline financial operations for MSMEs by reducing manual work, including payments and vendor management. Their integrated platforms enable businesses to efficiently track cash flow and offer essential services such as budgeting, accounting, and tax management at lower costs.

Disadvantages of Neo Banks:

1. Lack of Personal Assistance: Some customers may find the absence of in-person support for complex financial tasks frustrating. Older adults or individuals less familiar with technology may feel uncomfortable handling certain transactions without personal assistance.
2. Regulatory Uncertainty: Neo banks face a lack of regulatory clarity in India, as the Reserve Bank of India does not fully recognize fully digital banks. These banks must partner with traditional banks to provide services, which complicates their regulatory approval.
3. Trust Issues: Many consumers struggle to trust neo banks due to the absence of a physical presence and a traditional license. Even with government licenses, customers often view established banks as safer and remain cautious about using neo banks.

Opportunities for Neo Banks:

1. Integration with FinTech Companies: Neo banks can capitalize on technological innovations like APIs to integrate with third-party fintech services, such as budgeting tools, investment platforms, or insurance services. These integrations can enhance the customer experience, increase retention, and expand market share.
2. Personalized Financial Products: By leveraging data analytics, AI, and machine learning, neo banks can offer customized financial products, such as savings plans, loans, credit cards, and investment strategies based on user behavior and preferences. This personalization helps foster customer loyalty.
3. Growing Digital Acceptance: With a surge in internet access in India (from 14% in 2014 to over 52% in 2024) and an 87% acceptance rate for FinTech (higher than the global average of 64%), the increased digital adoption accelerates the growth of neo banks by broadening their customer base.
4. Rising Mobile Phone Usage: As mobile phones become more integral to managing finances, the customer base for mobile app-based neo banks continues to grow, making them increasingly accessible.
5. Sustainability and Green Banking: Neo banks can distinguish themselves by offering eco-friendly financial products like carbon-neutral credit cards or sustainable investment options, appealing to environmentally conscious consumers.

Challenges to Neo Banks:

1. Security and Trust: Security remains a significant concern for consumers, with risks such as data breaches, identity theft, transaction fraud, and potential insider threats. Many consumers hesitate to share sensitive financial information online due to these risks.
2. Regulatory Challenges: The regulatory uncertainty around neo banks is a major challenge, especially in markets like India, where neo banks are not fully recognized by bodies like the Reserve Bank of India. This lack of regulatory clarity can result in compliance and operational issues.
3. Competition from Traditional Banks: Traditional banks are adopting digital innovations, often with the help of fintech companies, to stay competitive. As a result, they are offering digital alternatives that compete directly with the services of neo banks.

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Future of Neo Banking in India

Neo banks have the potential to add value to the banking system. They can change the dynamics by expanding the reach of financial services and solving the challenges of financial inclusion. Services like opening bank accounts, facilitated via innovative onboarding procedures to providing instant credit facilities, these banks could assist in realizing the larger financial inclusion vision. These banks provide offerings such as accessibility, cost-effectiveness, and access to financial and non-financial functionalities with customer-centric approaches. Neo bank provides ease of doing banking activities with the help of Application Programming Interface (API), it also ensures fast payment and collection method, financial assistance, investment schemes, cashless environment etc. and it mainly focus on SMEs as they are proving themselves as a business of new era by using technology for doing their business. Neo bank overcomes the challenges faced by the individual in transacting with traditional banks such as clearance of cheque, money deposit, other services like bank statement for current account, lengthy documentation for loan processing. Neo bank eliminates all these difficulty by providing near real time services to its customer. Neo banks not only helping the businessmen but also to customers in different way. Neo bank also provides more interest rate on saving account or in investment fund than that of traditional banks. Neo bank also ensure fast opening of account in neo bank though are certain areas in which neo bank does not deal in which traditional banks do.

II. Conclusion:

India is emerging as a key market for neo banks. Despite the challenges they face, neo banks are gaining popularity due to their advanced technological innovations that meet the evolving needs of customers. As of 2020, smartphone penetration in India was at 56%, with projections suggesting it will reach 96% by 2040, according to a PWC report from September 2021. The transaction value in the neo banking sector is expected to reach $47,936 million in 2022, with a compound annual growth rate (CAGR 2022-2026) of 20.56%. By 2026, the number of neo bank users in India is projected to grow to 17 million, as per a Statista survey. These statistics demonstrate the vast potential for neo banks in India. The COVID-19 pandemic and the need for social distancing have accelerated the growth of neo banks, making their expansion almost inevitable. With nearly 190 million unbanked individuals, according to the World Bank's Global Findex Report, India is becoming an ideal location for neo banks. Traditional banks are also increasingly partnering with neo banks to enhance their digital capabilities.

The advancement of technology and digitalization brings benefits such as improved sustainability, convenience, and efficiency. As India is a hub for software development, digitalization is not difficult to adopt. The country holds significant market potential among developing nations. Neo banking will play a crucial role in achieving the goals of digitalization and development in the near future. Regulatory bodies and the banking sector are actively working to introduce innovative products within the neo banking framework, paving the way for further growth.

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