DOI 10.48614/bara.7.2022.6034

The Future of Neobanking

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Today we are witnessing the digital revolution, which in the coming decade will totally disrupt the Global Banking Sector. Neobanks are part of this revolution.

To be more specific, "change" is the keyword today - the change in the lifestyle of Consumers. The lifestyle changes were always occurring due to demographics, technological developments, fluctuating financial conditions of consumers and many other factors. However, some additional factors have recently accelerated this process, such as the fear for health due to COVID-19 and the consequent necessity for isolation.

In any case, the change in lifestyle is affecting the purchasing habits of Consumers. The change in purchasing habits of Consumers is manifested at each logical step of purchasing behavior, such as: the ways of searching for and getting the information, evaluating alternatives, making purchase decision and engaging into the purchasing process itself.

To be successful, the changes in Consumer purchasing behavior should be matched with the adequate Customer Value Proposition by the banking service providers, including Neobanks.

But, does the value proposition of the financial services providers (including Neobanks) match the changing purchasing habits of Consumers?

To answer this question, we have to start with the definition: "A neobank (also known as an online bank, internet-only bank, virtual bank or digital bank) is a type of direct bank that operates exclusively online *without traditional physical branch networks*" [1]. However this is the definition made from the perspective of a service provider. Now let's think from the perspective of a customer. The customer of a Neobank receives banking (or neobanking) services wholly online without visiting a branch.

Now, if a reader asks herself or himself - does it matter for me, as a customer, who provides to me the online banking services that I need: a truly online bank, or a bank that has some branches, or someone that even does not have a full banking license (e.g. payment service providers)? The answer will be: no, it does not matter for me, as long as I receive the service I need.

That's why in this article we are referring to Neobanking (please refer to the title of the present article) as to a wholly online banking service provided by different institutions, such as Fintechs and even traditional banks.

The forecast is that the market size of the Neobanks (in its traditional definition) will "grow at an annual average rate (CAGR) of 53.4 percent until 2030, reaching a value of 2.05 trillion U.S. dollars that year" [2]. However, if we use a more broad definition of Neobanking also including the digital banking services, then the market size will grow by around 3.6 percent CAGR reaching more than 13 trillion U.S. dollars in 2032 [3].

There are approximately 30,000 Fintech companies in the World (October 2022) [4] with the total value of investments into the Fintech Sector exceeding 1 trillion U.S. dollars [5]. The extreme competition within the industry is intensified because the traditional banks also transfer their products and services into digital channels. Take the example of two leading banks in Georgia: the retail offloading ratio of TBC Bank was 97% in 2021 [6], while the share of retail transactions through digital channels of Bank of Georgia was 96,1% in the same year [7].

The ways how to overcome the above mentioned extreme competition that is taking place in the Financial (Fintech) Sector, can be found in the Marketing Principles. Namely, back in 1990's article – "Four P's Passe; C-words Take Over" [8], Bob Lauterborn introduces the 4 C's (Customer, Cost, Convenience, Communication), which replace the 4 P's of the original marketing mix concept, as shown in Fig. 1 below:

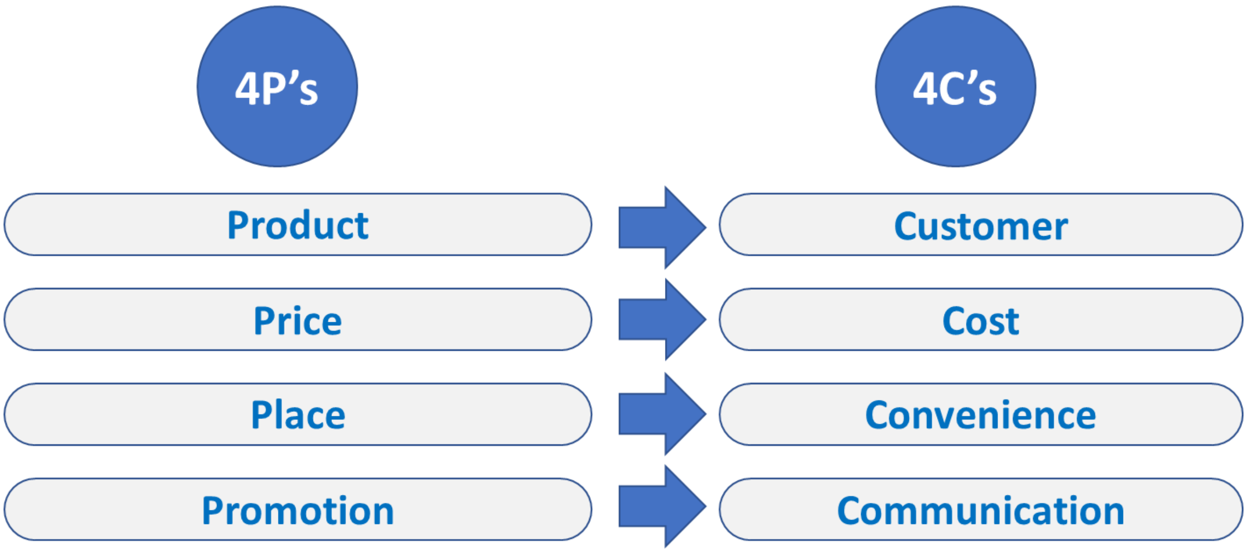

Fig. 1 Four P's of marketing mix is replaced by four C's

This shift from 4 P's to 4C's shows how the digital revolution is affecting the established principles: "product" is replaced by "customer", because mass customization in the digital world allows companies to deliver values to customers on an individualized way; "price" is replaced by "cost", because the marginal cost of distributing a digital product is zero; "promotion" is replaced by "communication", because the digital channels allow for direct communication to end users in a cost-effective manner.

The special comment should be devoted to "place", which is now replaced by "convenience". As it was suggested by Bob Lauterborn in his original article: "Forget place. Think convenience to buy. People don't have to go anyplace any more, in this era of catalogs, credit cards and phones in every room" [8]. This was said in the era of traditional landline phones, before emergence of mobile phones as a means of communication and a way before the smartphones emerged as platforms for receiving all kinds of digital products and services.

Today it is easy to shop, to pay, to order food or products, to book, to travel, to receive various kinds of digital products and services by using a mobile phone, all done in one place. Is it convenient? Definitely it is. That's how "convenience" has replaced "place". To summarize, the shift in marketing mix shown in Fig. 1 is caused by the changes in consumer behavior, which itself is affected by technological changes.

In order to demonstrate how technological and lifestyle changes may affect the consumer behavior, we can resort to historical parallels. The period after the WWII, especially the mid-1950s, experienced the increased car ownerships in the USA, which increased the mobility of shoppers. With the increased mobility, it became a lifestyle to combine shopping, entertainment and leisure in one trip as it was convenient for consumers. The evolved lifestyle has manifested itself in the changed consumer behavior. The retailing sector responded to this change with the emergence of shopping malls by means of providing all services in one place in a manner convenient for consumers.

Basically, what had happened in the mid of the last century in the USA, is nowadays explained by a so called "Blue Ocean Strategy" [9]. It defines the process of "simultaneous pursuit of differentiation and low cost to open up a new market space and create new demand. It is about creating and capturing uncontested market space, thereby making the competition irrelevant. It is based on the view that market boundaries and industry structure are not a given and can be reconstructed by the actions and beliefs of industry players" [10].

The Blue Ocean strategy is essentially the adaptation of a business to the shift occurring in consumer purchasing behavior. Although this theory was invented after 50 years from the massive occurrence of the shopping malls in the USA, it explains the rationale behind the adoption of the shopping malls as shown in Fig. 2. At that time the shopping malls differentiated themselves in the eyes of consumers (offering all services in one place in a convenient manner) and restructured the cost base for retailers (offering lower cost rentals to retailers compared to downtown locations).

Fig. 2 Shift in consumer behavior resulted in the emergence of Shopping Malls in the USA

Nowadays, it is *convenient* for consumers to use their mobile phones for receiving many different services - *all in one place* (that's how the "convenience" has replaced the "place" in the marketing mix). It only remains up to the businesses to adapt to the changed consumer behavior in a most convenient way for customers as it can be seen from Fig. 3.

Fig. 3 Modern-day shift in consumer behavior drives the emergence of Super Apps

Now we are in the position to answer the main question posed in this article: *does the value proposition of the financial services providers (including Neobanks) match the changing purchasing habits of Consumers?* If we agree that the value for a modern-day consumer is "convenience" by means of receiving virtually all services in one place (i.e. in a mobile phone), then the financial service providers should respond by creating the respective ecosystems. Is this the case?

The answer is No. Today, the financial services industry is fragmented into digital payments, loyalty platforms and neobanking/digital banking services to mention just a few. In addition, there are numerous companies offering E-commerce services/marketplaces, which increase the degree of defragmentation from the consumers' perspective. All these services are facing some problems when run in isolation as shown in Fig. 4 below:

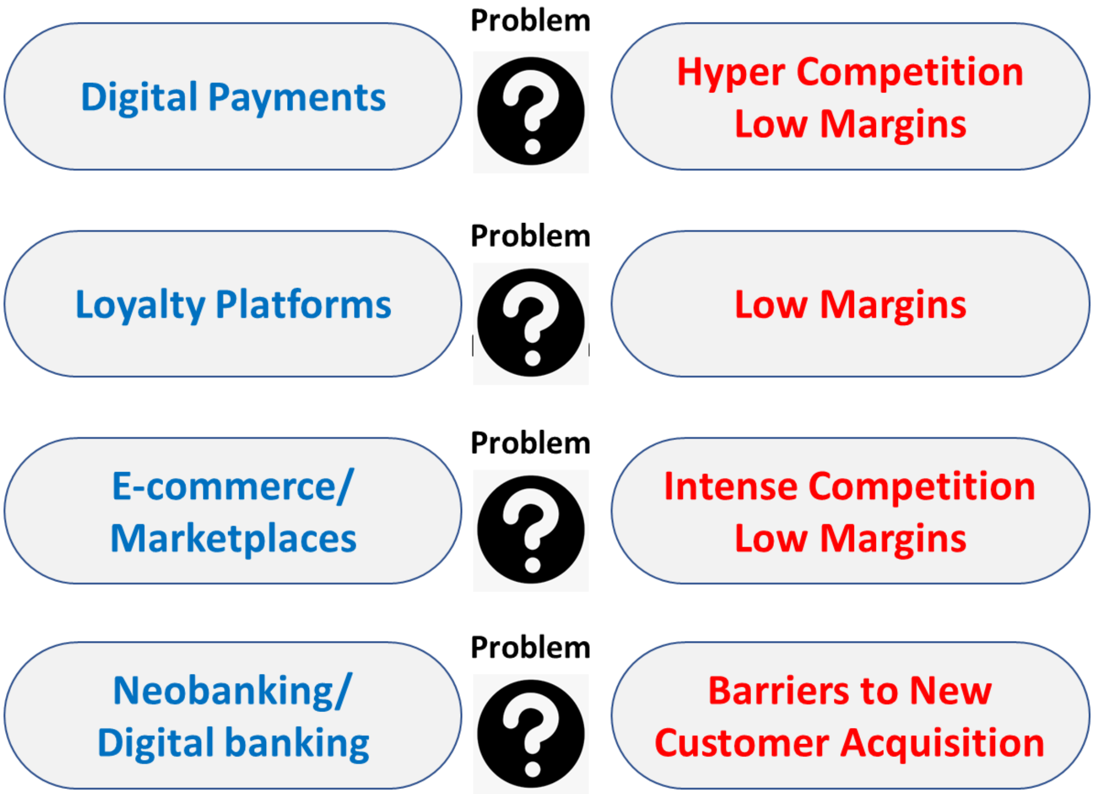

Fig. 4 Problems facing the individual industry players if run in isolation

It then follows that the individual industry players should think about creating more complex ecosystems. With such approach they will enhance the value proposition for consumers by offering many services in one place (convenience) and at the same time will overcome some of the above mentioned problems by means of achieving synergy effects and the economies of scale.

There are many options of incorporating different services into a single ecosystem of services. For example, consider loyalty platforms and digital banking. From the above statement of problems (refer to Fig. 4 above) let us choose two main dimensions: profit potential per customer and potential of new customer acquisition. As a next step, let us compare loyalty platforms and digital banking services with each other according to these two dimensions. The comparison is shown in Fig. 5:

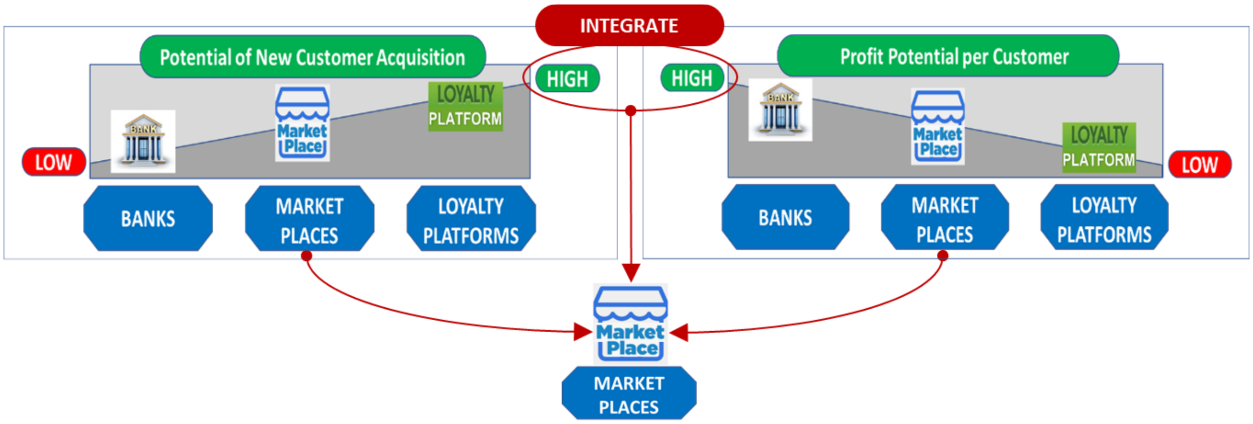

Fig. 5 Comparison of loyalty platforms and digital banking services

It can be seen from Fig. 5 that loyalty platforms have the highest potential of new customer acquisition because of the attractiveness of such programs to many consumers. At the same time the loyalty platforms have the lowest margins due to its nature. On the other hand (refer to Fig. 5), we can see that neobanks/digital banks have the lowest potential of new customer acquisition due to high competition and due to the barriers established by the traditional banks. At the same time the banks have the highest profit potential due to a high Customer Lifetime Value (CLV).

Therefore, the solution will be to unify both into a single ecosystem. But in order to originate the necessary transactions for banks, one will need to incorporate an additional component into the proposed ecosystem. Such component may be a marketplace as shown in Fig.5.

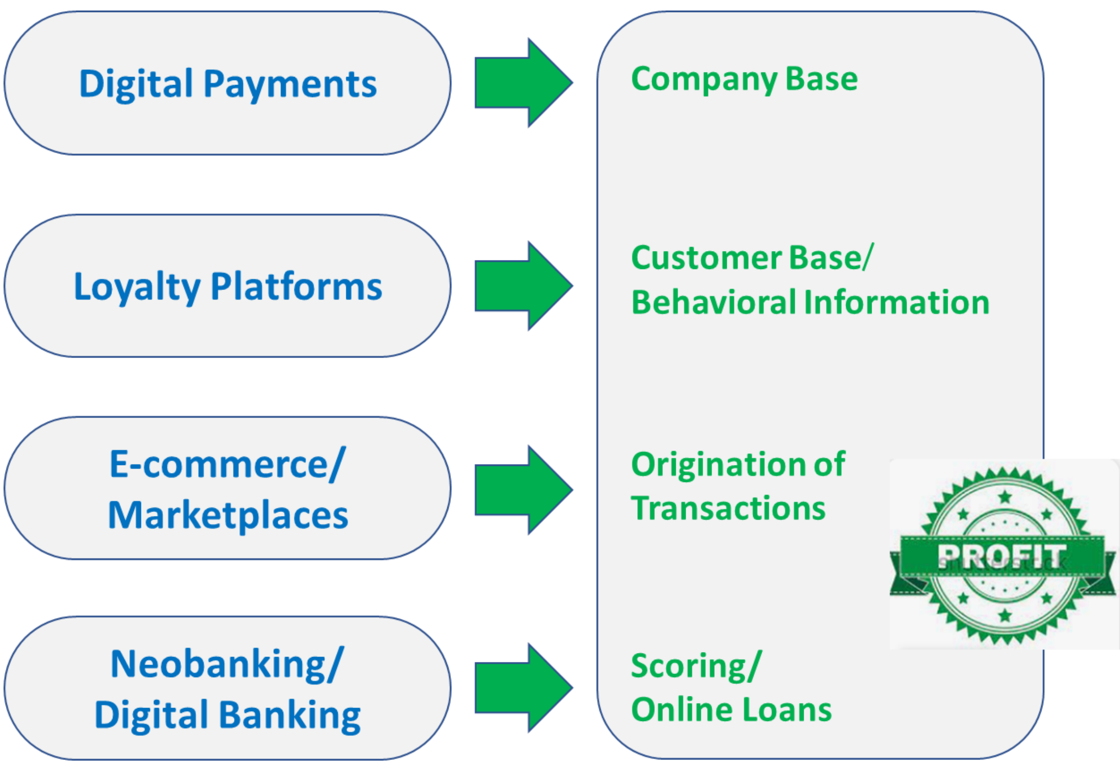

Fig. 6 The resulting ecosystem

The resulting ecosystem is shown in Fig.6. The business logic behind such ecosystem is the following: digital payments functionality will generate a large base of participating companies, as these companies look for reducing the transaction fees. Loyalty platforms will generate a large customer base and provide customer behavioral information to the participating banks (with the consent of customers). Banks will score the customer behavior information and will embed their offerings into the marketplace. As a result the banks will be able to issue online loans for consumers shopping at marketplace. The customers of the ecosystem will receive all the above mentioned services in one place (convenience). The resulting ecosystem will be profitable due to high CLV of banking products and services.

Summary

In order to summarize the future development of neobanking in just a few words, it can be stated: neobanking is the future. A lot of new financial ecosystems will emerge, some of them in partnership with the existing banking institutions. The examples of such initiatives can be seen everywhere: Visa and Mastercard are becoming digital, Apple and Amazon are incorporating the financial services, Paypal is extending its services into the loyalty industry, even Twitter and Google are seeing themselves as payment service providers. It only remains to see how these neobanking ecosystems will be reshaped in the coming decade.

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