



Neo-Banking Revolution: Challenges, Prospects, and the Road Ahead

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ABSTRACT

Neo-banks, digital-only financial institutions, have revolutionized the banking industry by offering cost-effective, user-friendly, and technology-driven services. These banks operate exclusively through digital platforms and provide personalized services, reduced fees, and enhanced convenience. This paper examines the growth, challenges, and prospects of neo-banks, with a focus on the Indian market. In 2023, the global neo-banking market was valued at \$98.40 billion, projected to grow to \$3,406.47 billion by 2032 at a compound annual growth rate (CAGR) of 48.6%. Europe currently leads the market, holding 38.32% of the global share. Despite their rapid growth, neo-banks face challenges such as regulatory ambiguity, cybersecurity risks, and competition from traditional banks. However, their innovative solutions position them to drive financial inclusion and provide customized products, particularly in emerging markets like India. This study delves into neo-banking's challenges and prospects, providing actionable insights for stakeholders navigating this evolving financial ecosystem and offering insights into neo-banks' future role in reshaping the global economic landscape.

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Introduction

The emergence of neo-banks, or digital-only banks, has transformed the global banking landscape. The concept began with *First Direct*, launched in the UK in 1989, which laid the foundation for this



innovative banking model. However, the term neo bank only gained recognition around 2017. Over the past decade, these institutions have experienced rapid growth, driven by their ability to offer a more convenient and user-friendly banking experience than traditional financial institutions. Neo banks leverage a digital-first approach, which allows them to minimize overhead costs associated with physical branches. This efficiency enables them to provide lower fees and higher interest rates. Operating solely through digital platforms, Neo banks provide streamlined and personalized financial services tailored to the dynamic expectations of digitally savvy customers. In India, pioneers such as *Niyo Solutions* have played a key role in introducing services that align with the digital era's needs.

Initially emerging in regions like the United Kingdom and Germany, neo-banks have bridged the gap between conventional banking services and modern customer demands. While their product offerings may be narrower than traditional banks', their focused approach enables them to provide customized solutions, competitive pricing, and greater operational flexibility. By reimagining the banking experience, neo-banks are redefining financial services for a rapidly digitizing world.

Despite the numerous benefits of neo-banking—such as cost-efficiency, financial inclusion, and innovative products—these institutions face significant challenges. Issues like regulatory ambiguity, cybersecurity risks, and competition from established banks remain critical hurdles. However, the increasing demand for digital banking and strategic collaborations with fintech companies give neo-banks opportunities to expand their reach and influence. This study delves into neo-banking's challenges and prospects, providing actionable insights for stakeholders navigating this evolving financial ecosystem.

Review of Literature

1. **Agarwal and Khera (2020)** state that neo-banks provide a more streamlined, cost-efficient approach than traditional banking models. The rapid adoption of mobile banking and internet connectivity has driven neo-banks' success, with many offering personalized financial services that are more flexible and customer-centric. This literature highlights how technology and innovation are central to the neo-banking model and how these institutions cater to the evolving needs of digital-first consumers.
2. **Patil et al. (2021)**, neo-banks have the potential to provide low-cost banking solutions to individuals who may not have access to traditional banking services. Their mobile-first approach allows customers in remote locations to access essential banking services, contributing to greater financial inclusion. The study also points to the significant role of neo-banks in India, where the unbanked population stands at a considerable number despite digital growth.



3. **Gupta (2022)** discusses the complexities associated with neo-banks operating in a grey area regarding regulation. While they are not subject to the same regulatory frameworks as traditional banks, they must still comply with various financial regulations such as Know Your Customer (KYC) and Anti-Money Laundering (AML) laws. Gupta argues that finding a balance between innovation and compliance is crucial for the long-term viability of neo-banks.
4. **Desai and Joshi (2023)** digital-only banks are prime targets for cyberattacks due to their online-only nature. They argue that neo-banks must invest heavily in robust cybersecurity measures to protect user data and maintain consumer trust. This paper emphasizes that cybersecurity risks such as data breaches and fraud can severely affect neo-banks' reputation and regulatory compliance. It highlights the need for continuous technological upgrades to mitigate these risks.
5. **Sharma and Verma (2020)** argue that neo-banks' main competitive advantage lies in their ability to provide tailored solutions such as personalized savings, budgeting tools, and instant payment systems. By leveraging data analytics and artificial intelligence, neo-banks can offer highly personalized banking experiences, increasing customer satisfaction and loyalty. This has allowed neo-banks to grow rapidly and challenge traditional banking models.

Need and Objective of Study

The rapid growth of neo-banks has disrupted the traditional banking sector, introducing innovative, customer-centric financial services through digital platforms. With rising smartphone penetration, internet accessibility, and evolving customer expectations, understanding nonbanks' role in addressing financial inclusion, offering cost-efficient solutions, and fostering innovation is crucial. This study is necessary to explore neo-banks' prospects and challenges in the global financial ecosystem, particularly in India.

Research Methodology

This study adopts a descriptive research approach and relies entirely on secondary data sources. Information was gathered from various resources, including journal articles, newspapers, and websites. By analyzing these sources, the study provides an in-depth understanding of the trends, challenges, and opportunities associated with neo-banks, ensuring a comprehensive and reliable analysis.

Discussion

Concept of Neo-banks

Neo banks are fintech companies that replicate traditional banking services through entirely digital platforms, offering a wide range of financial applications and services. All transactions are conducted



online, ensuring security, customization, and greater convenience than traditional banks. By eliminating practices such as cash deposits, extensive paperwork, and in-person interactions with bank officials, neobanks break away from conventional banking norms.

The core purpose of neo-banks is to deliver innovative, cost-effective financial services powered by fintech and AI, filling the gaps left by traditional banking models. Unlike conventional banks, neo-banks operate without physical branches. In India, while the RBI does not directly regulate neo banks, they collaborate with RBI-registered banks like ICICI and HDFC to ensure regulatory compliance and maintain operational integrity.

Neo Banking Growth

The neo-banking market has experienced unprecedented growth fueled by technological advancements, shifting customer preferences, and increasing digital adoption worldwide.

- **Market Size:** In 2023, the global neo-banking market was valued at **\$98.40 billion**, with projections indicating a meteoric rise to **\$3,406.47 billion by 2032**, reflecting an exceptional compound annual growth rate (CAGR) of **48.6%**. This surge highlights the growing acceptance of digital-first banking solutions and neo-banks' ability to redefine the financial services landscape.
- **Regional Market Share:** In 2023, **Europe** led the global neo-banking market, accounting for **38.32%**. This leadership is driven by the region's favourable regulatory frameworks, high levels of digital literacy, and a robust fintech ecosystem. However, emerging markets in **Asia-Pacific** and **North America** are poised for significant growth, driven by increasing smartphone penetration, innovative financial solutions, and the demand for financial inclusion in underserved regions.

Differences Between Neo banks, Digital Banks, and Traditional Banks

Table 1: Differences Between Neobanks, Digital Banks, and Traditional Banks

Features	Neo Banks	Digital Banks	Traditional Banks
Customer Support	Online-Only	Online-Only	In Person and online
Banking License	None, Partial or Full	Partial	Full
Service Channels	Mobile Apps and Web Platforms	Mobile Apps and Web Platforms	Physical Branches, Web, and Mobile
Account Application	Fully Online	Fully-Online	In-Person
Approval Process	Fast	Fast	Manual and time intensive
Regulation	Follow RBI and	Regulated	Regulated



	Government regulations, not directly regulated by traditional banks		
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Source: <https://freo.money/guides/neobanks-in-india/>

Table 1 highlights the key differences between neobanks, digital, and traditional banks. Neobanks operate entirely online, offering fast approval processes and leveraging mobile and web platforms, but they may lack full banking licenses and are not directly regulated by traditional banking authorities. Digital banks, while also online-focused, have partial licenses and are regulated, bridging the gap between neobanks and traditional banks. With full licenses and comprehensive regulation, traditional banks rely on physical branches alongside digital services, offering in-person support but slower, manual processes. This comparison underscores these banking models' trade-offs between convenience, regulation, and service channels.

Neo Banks in India

Table 2: List of Neo Banks in India

Sl.No.	Name of Neo Bank	Interest Rate	Account Type	Founders	Year of Establishment
01	Razorpay	-	Business Account	Harsheel Mathur	2013
02	Instantpay	-	Business Account	Shailendra Agarwal	2013
03	Freo	Up to 7%	Personal Savings Account	Bala Parthasarathy, Anuj Kacker, Kunal Varma	2015
04	Niyo	Up to 7%	Personal Savings Account	Vinay Bagri	2016
05	Chqbook	-	Business Account	Vipul Sharma, Rajat Kumar, Mohit Goel	2016
06	Fi Money	Up to 3%	Personal Savings Account	Sumit Gwalani, Sujith Narayanan	2019
07	Jupiter	Up to 4.75%	Personal Savings Account	Jitendra Gupta	2019
08	Fampay	-	Personal Savings Account	Kush Taneja, Sambhav Jain	2019
09	Finin	Up to 5%	Personal Savings Account	Suman Gandham, Sudheer Maram	2019



10	Zikzuk	-	Business Account	Raj N	2020
11	Akudo	-	Business Account	Lavika Aggarwal, Sajal Khanna, Jagveer Gandhi	2020
12	Mahila Money	-	Business Account	Sairee Chahal	2021

Source: <https://freo.money/guides/neobanks-in-india/>

Table 2 lists prominent neo-banks in India, highlighting their interest rates, account types, founders, and year of establishment. It includes a mix of personal savings and business account providers, with interest rates up to 7% for savings accounts. Notable players like RazorpayX, Niyo, and Jupiter cater to diverse customer needs. The table reflects the rapid evolution of neo-banks since 2013, driven by innovative fintech solutions. These digital-only banks are shaping the future of banking in India through convenience and tailored services.

Challenges and Prospects of Neo Banks

Challenges of Neo Banks

1. Regulatory Uncertainty

Neo-banks operate in a grey area where legal definitions and frameworks are not fully established. For instance, licensing models often differ significantly across regions. In some countries, neo-banks cannot offer full-fledged banking services due to regulatory restrictions, forcing them to partner with traditional banks. Such dependency limits their autonomy and innovation. Neo-banks need to navigate strict regulatory environments without stifling innovation. Overregulation can restrict their ability to introduce disruptive products, while under regulation may lead to customer and financial system risks.

2. Cyber Security Risks and Privacy

Digital-first operations make neo-banks a prime target for cyberattacks, phishing scams, and ransomware. Customer trust hinges on robust data encryption and adherence to privacy standards like GDPR (General Data Protection Regulation) or equivalent regional laws. A single breach can erode user confidence and invite significant penalties. As cyber threats grow in sophistication, neo-banks must continuously invest in cutting-edge security technologies and practices to safeguard customer data and prevent fraud.

3. Competition from Legacy Banks

Traditional banks with decades of customer trust, robust branch networks, and diversified portfolios often outcompete neo-banks in customer acquisition and retention. Many are rapidly digitising to match neo-banking's technological advantages, intensifying competition. Neo-banks often lack the historical



credibility of legacy banks. Establishing trust requires consistent service delivery, transparency, and a focus on user security.

4. Customer Acquisition Costs

Unlike traditional banks with a built-in customer base, neo-banks must invest heavily in marketing, often using incentives like cashback or free trials, increasing operational costs. Retaining these customers after the acquisition is equally challenging.

5. Scalability Challenges

As neo-banks grow, maintaining a seamless user experience while managing a larger volume of transactions and accounts can overwhelm existing technological infrastructure, leading to downtime or slower service. Balancing growth with service reliability is a major challenge, particularly when entering new markets or serving diverse customer bases.

6. Limited Product Range

Many neo-banks focus on simplified offerings like payments and savings accounts, which are easier to scale but fail to meet the broader financial needs of consumers, such as wealth management or insurance. This limitation often leads customers to seek comprehensive services from traditional banks.

7. Dependence on Technology

Any system downtime or technology malfunction directly impacts user experience and trust. For instance, users may face interruptions during peak traffic or updates, which are less common in traditional banks due to diversified service delivery modes. Adopting AI, blockchain, and machine learning requires significant investment, but these technologies are critical for staying competitive.

8. AML/KYC Compliance

It is tricky to Streamline Anti-Money Laundering (AML) and Know-Your-Customer (KYC) protocols without frustrating users. Neo-banks need to ensure compliance while providing an intuitive and user-friendly onboarding process.

9. Financial Inclusion Barriers

Although neo-banks aim to serve underserved populations, challenges like digital literacy, lack of internet access, and resistance to change in rural areas hinder their efforts.

Prospects of Neo Banks

1. Rising Digital Adoption

The rapid increase in smartphone penetration and internet accessibility is revolutionising how financial services are consumed, particularly in developing economies with limited traditional banking infrastructure. Neo-banks are positioned to capitalize on this trend with their mobile-first platforms and



tech-driven services. By addressing the needs of digital-first customers, including millennials and Gen Z, neo-banks are setting the stage for the widespread adoption of digital financial solutions.

2. Lower Operational Costs

The absence of physical branches allows neo-banks to operate with significantly reduced overhead costs compared to traditional banks. These savings empower them to focus on key areas such as technology innovation, marketing strategies, and customer acquisition. By redirecting resources to digital platforms and analytics-driven tools, neo-banks can consistently enhance their offerings while maintaining competitive service pricing.

3. Personalised Services

Neo-banks leverage advanced technologies such as big data and artificial intelligence (AI) to offer highly customized financial solutions. For example, they can provide insights into spending patterns, suggest budget management strategies, and offer personalized credit options. These tailored services enhance user satisfaction and create a sense of exclusivity and relevance for customers, fostering loyalty and engagement.

4. Real-Time Payments and Settlements

In today's fast-paced world, customers value efficiency and convenience. Neo-banks address this demand by enabling instant payments and settlements for peer-to-peer transactions, merchant payments, or bill settlements. This capability improves customer satisfaction and positions neo-banks as the go-to solution for users prioritising speed and reliability in financial services.

5. Catalyst for Financial Inclusion

Neo-banks are bridging the financial divide in regions where traditional banks have a limited presence. Their low-cost, mobile-first approach makes financial services accessible to unbanked and underbanked populations. Neo-banks empower individuals and small businesses by offering basic accounts, digital wallets, and micro-lending options, fostering economic participation and growth.

6. Product Innovation

Neo-banks are at the forefront of introducing innovative financial tools that resonate with modern users. These include micro-investment platforms allowing users to invest spare change, credit-building accounts for those with limited credit history, and goal-based savings features encouraging financial discipline. By catering to niche financial needs, neo-banks are redefining how banking products are conceptualized and delivered.

7. Strategic Partnerships



Neo-banks frequently collaborate with fintech firms, technology providers, and industry leaders in e-commerce, travel, and retail sectors. These partnerships enable seamless integration into broader ecosystems, allowing neo-banks to provide value-added services such as rewards programs, cashback offers, and embedded financial solutions. Such alliances expand market reach and enhance customer satisfaction by meeting diverse needs through a single platform.

8. Data-Driven Strategies

With access to vast customer data, neo-banks can identify emerging trends, predict customer needs, and proactively address potential issues. Sophisticated analytics tools allow them to fine-tune risk management practices, launch targeted marketing campaigns, and offer customized financial solutions. This data-driven approach helps neo-banks remain agile and competitive in an evolving market landscape.

9. Customer-Centric Engagement

Neo-banks prioritize customer experience by incorporating gamified features, user-friendly interfaces, and simplified onboarding processes. For example, rewards for achieving savings goals or interactive dashboards for tracking financial health can engage users more effectively than traditional banking methods. This focus on engagement ensures higher customer satisfaction and retention rates.

10. Employment Opportunities

The neo-banking sector contributes to job creation in technology development, operations management, and customer service. As neo-banks expand their offerings, there is a growing demand for specialists in AI, cybersecurity, data analytics, and user experience design. This supports the fintech industry and drives economic growth by fostering a skilled workforce.

Conclusion

Neo-banking marks a revolutionary shift in the financial sector, offering a digital-first alternative to traditional banking by leveraging technology for cost-efficiency, personalization, and accessibility. While challenges like regulatory ambiguity, cybersecurity concerns, and scalability remain, neo-banks hold immense potential to drive financial inclusion, enhance customer experiences, and foster innovation. To fully realize their potential, neo-banks must work closely with regulators to develop balanced frameworks that encourage innovation while ensuring compliance, prioritize robust cybersecurity measures to protect customer data, diversify their product offerings to cater to a wider audience and integrate advanced technologies such as AI and blockchain to enhance service delivery. By



focusing on these critical areas, neo-banks can position themselves as frontrunners in the digital banking revolution, fostering a more inclusive, efficient, and forward-looking global financial ecosystem

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