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LESSONS LEARNT FROM THE PAST FOR PLANNING RAPID GROWTH

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Accelerating Financial Inclusion in India: A Case for Neo Banks

Shree Jyothi Koutha

Abstract

Neo banks are virtual banks without any physical presence and have emerged as a result of progress in information technology in terms of internet and innovation of existing products and services. These banks have emerged across the globe under various modes of operations and India is also witnessing the emergence of the same albeit with lot of restrictions. India is emerging into a digitally advanced nation with increasing rate of digital awareness and technology adoption resulting in the connectivity achieved throughout the country by means of technology. Though the access to the formal banking services is increasing with good progress a lot is yet to be done in bringing large number of households into realm of formal financial services. This paper attempts to study the existing digital infrastructure coupled with the digital adoptions, enabling the emergence of virtual entities offering various financial services. The data relied upon for the study is secondary data available in the various public domains. The study attempts to model the emergence of neo banks and builds a case for the formalization of neo banks in Indian banking environment.

Keywords: Neo banks, financial services, India, descriptive, secondary data

1.Introduction

The banking industry in India has witnessed tremendous growth from the days of nationalization. The liberalization of economic policies and the liberalized licensing regimes have added to the dramatic changes in the sector. The implementation of prudential norms in line with Basel recommendations have put Indian banks on par with international banks and has changed the way traditional banking was done. Global competition has driven the digitization of bank with implementation of core banking systems enabling the reach and growth for the banks with improvised service levels and customer experience coupled with innovative products and services.

Neo bank can be defined as a virtual bank without any specific location for its branches. It is kind of a bank supported entirely by technology with its existence is in the web of technology and is a fintech product. The origination of Neo banks happened in Europe and now has spread all over the globe since the past two years.

The pandemic has witnessed explosion of neo banks across the globe. Research by Publicis Sapient shows that of the roughly 240 operating globally in April 2021, more than 20% had launched in the previous 12 months as Covid-19 spread around the world. The profile of neo banks varies across the regions with UK offering fully operational digital banks replicating the traditional banks whereas US list few of them. This is mainly because of the licensing for new entrant being an easier process in UK whereas getting banking license in US is very difficult comparatively.

The neo banks in US are not fully licensed and need to partner with traditional banks so as to provide banking services in "back end" model with payments bringing in major component of their revenues. In contrast it is easy to get a banking license especially in neo banks, in Europe with lending playing the major role in the operations of neo banks, netting in major revenues as increased net margins and services play critical role in the income apart from the fees collected for the payments.

The neo banks in South America show same trends as those in North America with revenues coming in the form of commissions on payments in partnership with Brick-and-Mortar banks. Brazil proves to be emerging market for neo banks

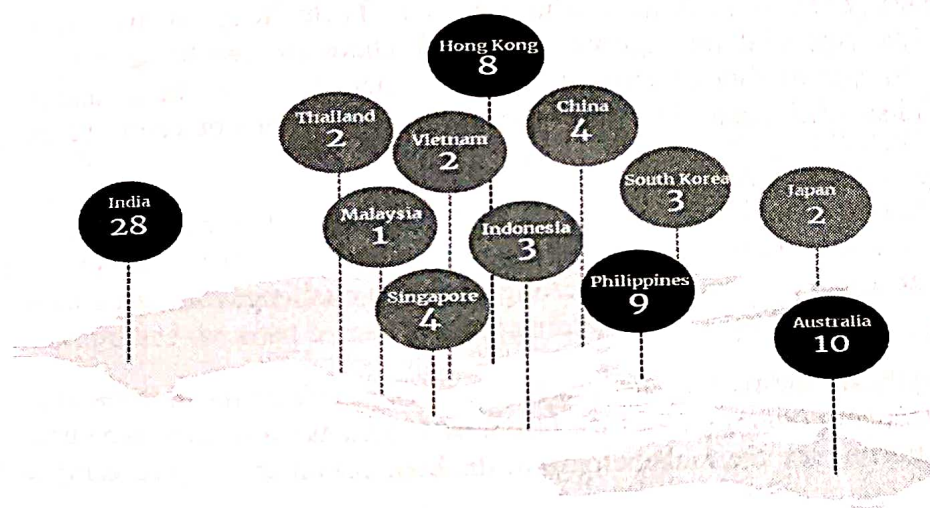
Boasting around 19 neo banks including Nubank, by far the region's biggest with 40m users. Nubank, is the third most valuable firm achieving a \$42bn IPO and makes most of its revenues from interest on credit card balances and payments.

The scenario in Asia is varying with many popular apps such as Tencent, WeChat, Grab and WhatsApp making inroads through digital payments. Chinese neo banks are focusing on small business as of now while Korean neo banks are offering full service neo banks. Philippines is becoming a healthy ground for origin and growth of neo banks offering services to small business and retail customers. India is witnessing tremendous pressure in terms of growth of neo banks though officially no permission has been granted by RBI for full-fledged neo banks in India.

The neo banks based out of Australia began with offering full-fledged services with more focus of business customers. However, this model proved detrimental in a mature market with intense competition as two of the country's neo banks forced to exit the market.

Figure 1.1: Number of Neo banks in APAC

Number of neobanks in the APAC region, 2020



Source: Twimbit analysis

Operating model of Neo banks:

The typical operating models of neo banks are

- No license neo banks
- Licensed neo banks
- Digital banks of traditional banks

Success factors of neo banks:

The key success factors of the neo banks can be highlighted as

- User-friendly and engaging app experience.
- 24/7 Chatbot support.
- High security features.
- Personalized offers depending on income and expense cycle.

- No monthly fees and low services costs.
- Higher FD and savings interest rates.

The aim of the paper is to study the digital infrastructure adoption of technology and look at the need for innovative entities like neo banks to accelerate the financial inclusion in India.

Objective of the Study

This paper attempts to study the present digital scenario in India and the growth of digital payments along with the need for the neo banks, enabling seamless banking services to underbanked and those with small ticket banking requirements.

Methodology

This paper is based on the secondary data available in various public domains. The study is descriptive in nature relying on the current studies available along with the data and interpreting the same to build a model for the neo banks.

2. Literature Review

Jagadeesha R Bhat and others (2022) have detailed what Financial Technology involves and review how disruptive technologies like Artificial Intelligence, IoT, block chain etc can bring in innovative products and services in the domain of finance enabling the customers to access better and cheaper products by the enablement and simplification of various process like KYC, fraud detection, verification and lending.

Dokania, Y. (2020) NEO Bank-Revolution in Indian Banking Sector-A Critical Analysis did an analysis of Neo banks and their functioning differentiating them from traditional banks and other digital banks. The article highlights advantages of neo banks along with the challenges faced by them. The article also studies the present regulatory landscape regarding the neo banks.

Rao, Harshitha(2020) has explained the reasons for the success of the neo banks in terms of ease of transaction simplification of account opening processes, seamless payments and smart reporting. User friendly interface and smart reporting are the tools helping in the business to grow by adopting the neo banking culture.

Wewege L, Lee J and Thomsett MC (2020) in their paper have examined various types of products and services offered by fintech, using the technology. The technology helps in being more customer centric offering faster and free services. They observe that digital only neo banks focus on payment services, money transfers and loans to small businesses, microfinancing and enabling peer-to-peer transactions. The value perceived in these fintech banks in enabling the partner's banks in the faster adoption of the technology as part of their digital transformation, but they lack scale and trust on their own with credit and liquidity risks.

Subodh Sakpal and Rashmi Soni (2019) the article "A study of Opportunities and Challenges Faced towards Sustainability of Digital Payments Banks in India". This article studies whether the advantages offered by the payments bank is the motivating factor for its adoption. Also, an attempt has been made to study the awareness about the payment banks. Also, whether the disadvantages of the payments bank have any impact on their usage has been studied. The relationship between the security threats and its impact on the usage of payments bank has been explored. The study concludes that digital wallets offered by payment banks have gained huge popularity because of the convenience and various associated benefits. Awareness about the wallets and their benefits is the key for the increased usage and the customers are not very much worried about the security threats.

Fritschi L N (2019) has mentioned in his paper that financial crisis of 2008 has triggered new set of players backed by technology like Fintech to improve the financial services and for introduction of new and innovative products, branding themselves as Neo Banks. The authors looked at possible disruption of existing banking businesses by the new players using the disruptive innovation theory of Clay Christenson in the context of Swiss banking sector. Their study suggested that Neo Banks cannot be considered as disruptive yet and the incumbents are dealing with a sustaining strategy dealing with adoption of digitalization of internal processes.

Derryl D'Silva and Others (2019) has detailed about the digital infrastructure for finance in India being built on modular and open-source architectures and standards, covering identity, payments and data sharing that needs to work concurrently for the successful implementation of digital payments.

I.M. Minarchenko, I.L. Sajko (2018) in the article "The Future of Neobanks in the Development of Banking Sector" did a descriptive analysis highlighting the characteristics, functioning and advantages of neo banks Vis-a Vis traditional banks.

RBI Working Group report (2017) has studied various aspects of digital banking and fintech in the Indian market. The reported has described the digital infrastructure and innovative products and services based on the technologies like IoT, peer to peer lending, cloud computing, block chain, eKYC, digital wallets, chatbots etc.

3. Eco System for Neo Banks in India

India has been an underbanked country since independence. The nationalization of banks has given impetus for the growth of banking industry in India but could not meet the requirements, needs and aspirations of India. With the initiation of economic liberalization and Information Technology industry growth the capital requirements along with other banking services has risen dramatically putting pressure on traditional banking system. The entry of new generation IT enabled players has changed the way the financial transactions are done with money being dealt digitally. The demonetization in 2016 has further pushed the need for digital transactions.

To accelerate the financial inclusion in India, RBI has adopted the bank driven initiatives with expansion of branches in the rural areas and mandatory opening of rural branches along with urban areas. RBI has further liberalised and has given permission for the opening of Small Finance banks and Payments banks mainly driven by the technology to enable faster and easier on boarding of customer and provision of basic banking services. The Government of India has also come out with the initiative of Jan Dhan Yojana where marginalized people have been facilitated to open bank accounts so that they can enjoy all the benefits and subsidies provided by the government through Direct Benefit Transfer (DBT).

By the year 2020, India had 749 million users of internet with the growth expected to be at 1.5 billion users by the year 2040. The growth of internet penetration was from 34.4% of population in 2017 to 47% in 2021. The silver lining is that the growth is being registered in both urban and rural regions. The surge in the internet users can also be attributed to the growth of mobile users in India with cheap availability of smartphones along with cheap mobile data.

According to RBI, India's Financial Inclusion index is at 56.4% by the end of March 2022 as against 53.9% by the end of March 2021 and 43.4% for the period ending 2017, meaning that 56.4% of households has access to a wide range of financial services at a reasonable cost.

According to the data published by RBI, the Digital Payment Index (DPI Index) continues to demonstrate significant growth in adoption and deepening of digital payments across the country. The index series since inception is as under:

Figure 3.1: Digital Payment Index in India

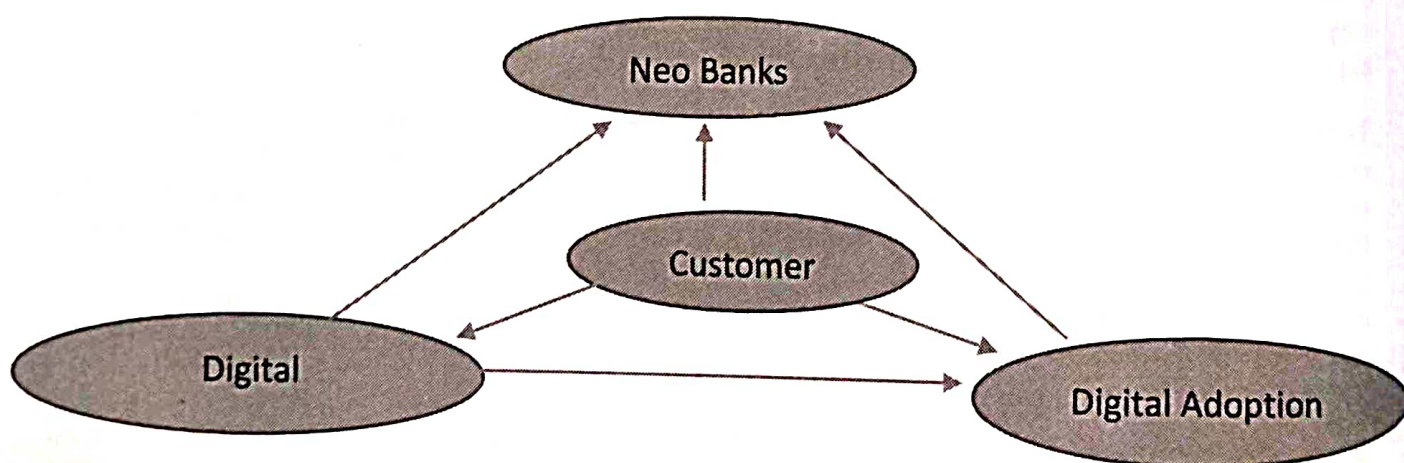
Period	RBI - DPI Index
March 2018 (Base)	100
March 2019	153.47
September 2019	173.49
March 2020	207.84
September 2020	217.74
March 2021	270.59
September 2021	304.06

Source: Reserve Bank of India (RBI)

4. Interpretation

Based on the existing literature and the given digital infrastructure for finance services industry, the model for Neo bank can be depicted as:

Figure 4.1: Conceptual framework for emergence of neo banks



Source: Authors Compilation

The availability of digital infrastructure along with the willingness of customers to adopt the technology enables the financial services providers to innovate the existing products and services along with introduction of new tech enabled products. The increased usage of technology enables the service providers to adopt neo banking with virtual presence and dismantling the need for the physical presence and services.

5. Regulations for Neo Banks in India

Reserve Bank of India has not permitted licensed full-fledged the neo banks in India as it believes that the existing banks, NBFCs and other financial service providers can adopt and leverage better and latest technologies to offer innovative products and services. The RBI is not yet ready to license digital only banks mainly because it believes that the concept is ridden with inherent risks.

Conclusion

India has made rapid progress in terms of providing banking and other financial services for the past few decades. The financial inclusion index has been continuously improving bring large number of households within the ambit of legal financial services. The advent of information technology coupled with internet and mobile technologies has enabled innovation in the products and services being offered by the financial institutions. Favourable growth in terms of internet and smart phone penetration in India has triggered growth of digitization of banking and emergence of neo banks. However, still large number of households are yet to access formal banking and other financial services. The Adoption of technology by both the financial organizations and people at large is culminating in reshaping the traditional banking units with emergence of entirely virtual entities, like neo banks, offering basic banking services. The emergence of neo banks across the globe and their success stories need to be replicated in India so that cheaper, faster and innovative series can be offered in India also.

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