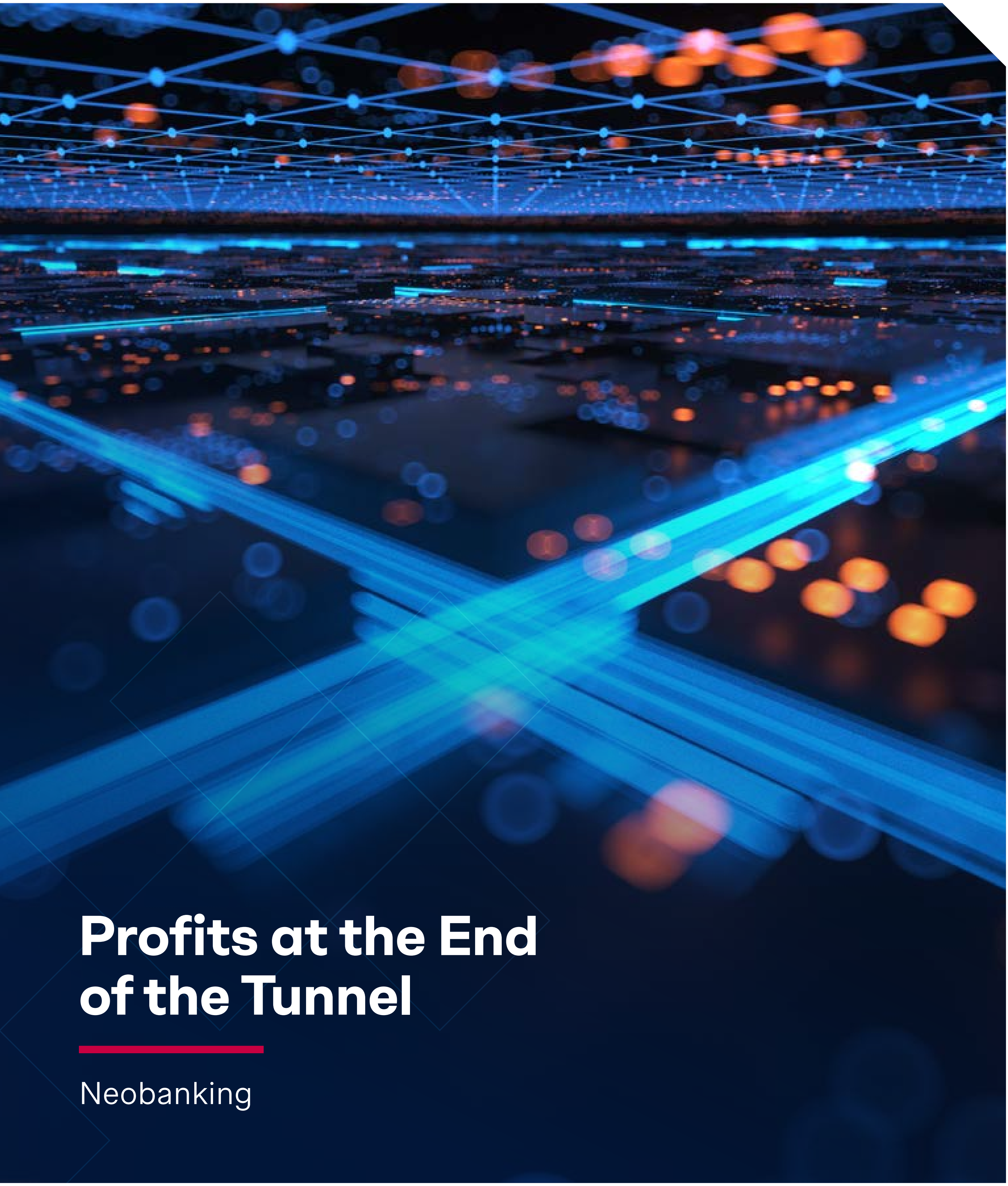

Profits at the End of the Tunnel

Neobanking

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Neobanking – profits at the end of the tunnel

In May 2022, we published our Future of Neobanking report, which looked at the current state of the industry, how it was faring in major geographies, and how more neobanks could become profitable.

At that time, this almost one billion client business, worth over 300 billion, was facing a profitability problem: based on available financial data and our own experience in the sector, we concluded that less than five percent of these challengers had reached breakeven. Unfortunately, the staggering growth of neobanks and their impressive valuation numbers did not widely translate into profitability.

Only a year and a half later, and a lot has changed, with both adverse and favorable impacts on the industry: inflation rates have been on a rapid upward march and, in many countries, reached multi-decade highs. To tame it, central banks have been hiking interest rates in unison, changing the basic rules of banking – making lending riskier and more challenging but also opening new growth and monetization routes for those building a sizeable balance sheet. And most directly impacting the industry, fundraising has become an unexpected challenge for neobanks and fintechs alike.

Particularly that scarcity of funding has put increasing pressure on neobanks to pivot from growth at all costs toward profitability. That's why our latest Future of Neobanking – Profits at the End of the Tunnel report looks at the neobanking industry through the monetization lens, focusing on three key areas:

1. State of the industry update – how are neobanks doing on their path to profitability?
2. Emerging winners in the race to profitability – and what they do differently
3. Profit hacking – tangible ways to monetize neobanking clients

State of the industry update – how are neobanks doing on their path to profitability?

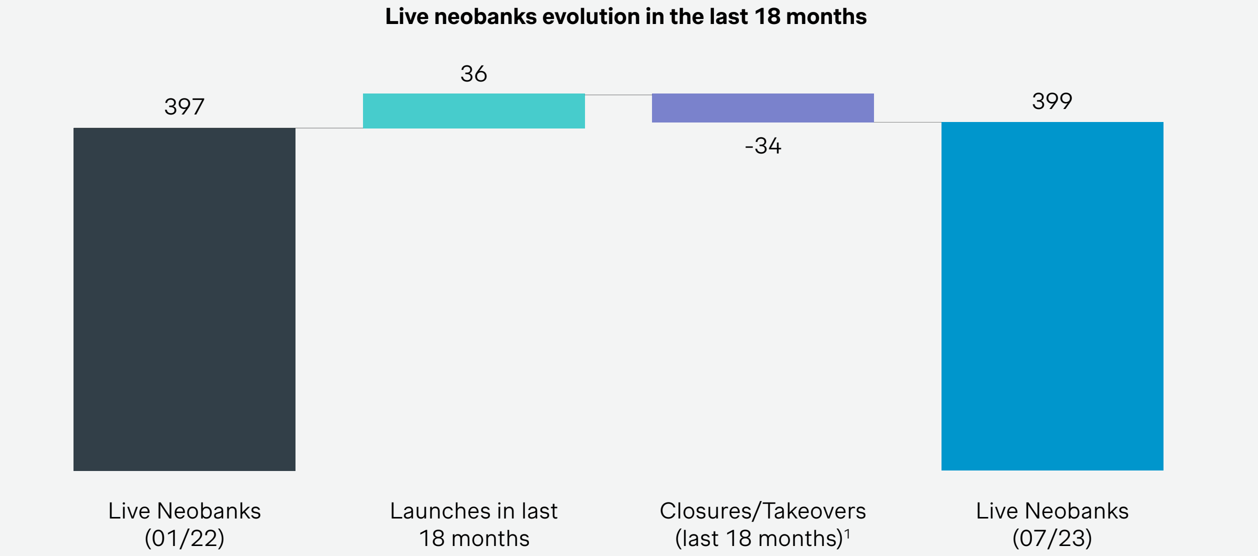
The number of gold panners stabilizes…

Since the first challenger banks emerged, neobanking has drawn in a myriad of investors and endless new players. The promise? Rapid reach and, eventually, the ability to get rich. Over the years, more and more challengers entered their bid with almost 100 new neobanks launched in 2020 – resembling a gold rush in the years pre-Covid.

In our 2022 report, however, we had already identified a deceleration in the number of newly established neobanks and suggested that the industry was potentially reaching its peak. Our latest data now indicates that, at a global level, neobanking has moved into a new evolutionary stage as the number of live neobanks has remained nearly constant at around 400. This is the consequence of several accelerating trends:

- The number of **new launches continues to decline** – we counted "only" 36 new players setting sail in the last 18 months; those that do launch, however, are now more often speedboats of existing financial groups and in many cases heavily funded to make a bigger splash in the market. Two examples are Wio (UAE) jointly owned by ADQ, Alpha Dhabi, e&, and FAB as well as ANEXT Bank (Singapore), an Ant Group's subsidiary.
- Other neobanks are exploring the **benefits of joining forces** as mergers become a real option. The takeover of Penta by Qonto in the European SME space or the reported discussions between Monzo and Lunar are likely just the tip of the iceberg of what's going to happen in an accelerating market consolidation.
- Another group of challengers is either being acquired or simply unable to secure their necessary capital injections, causing them **to throw in the towel**. This happened for example to Volt Bank Ltd. The first online-only bank to gain an Australian banking license had to shut down in June 2022 after failing to raise enough capital. UK-based neobank Bank North met the same fate, declaring insolvency in October 2022 after failing to raise the funds needed for a full banking license from the Bank of England.

In summary, a total of 34 neobanks disappeared from our radar over the last 18 months, nearly offsetting the count of new players entering the scene.

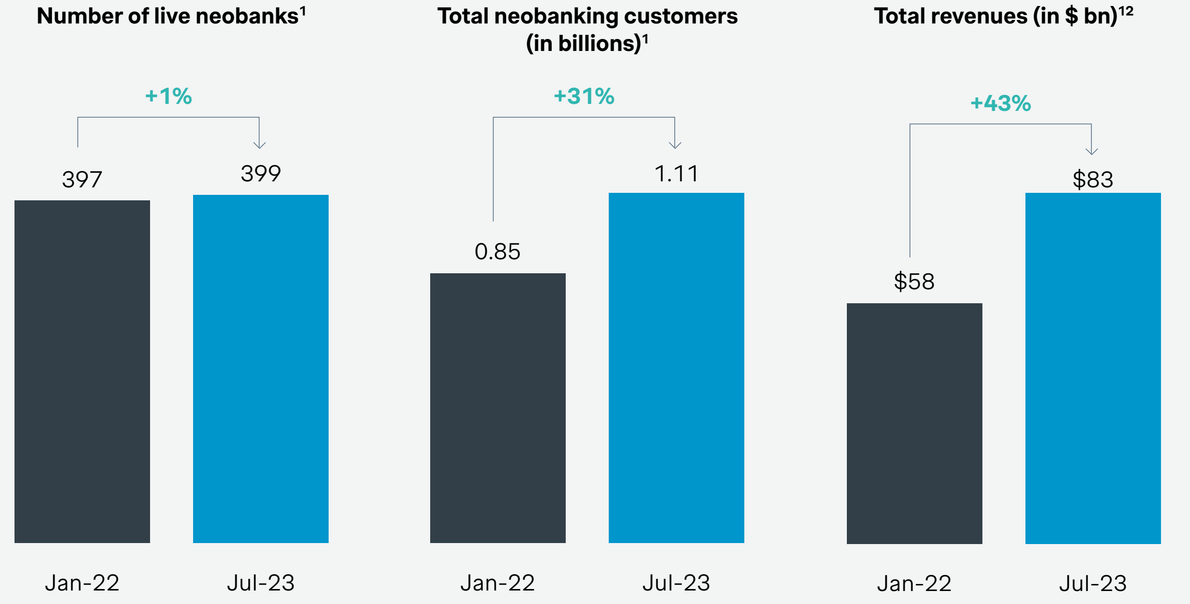


Simon-Kucher Neobanking Database | Notes: 1) Includes neobanks that either ceased operations, were merged into another entity, or pivoted outside neobanking

…but the gold rush continues

The number of neobanks might no longer be on the rise, but other growth indicators remain intact:

- **Rise of true neobanking "giants":** Among the largest industry players, 20 neobanks are now hosting 10 million or more clients (and 39 with more than 5 million), ranking several of them in the top 5 or 10 of the largest banks in their respective country, truly disrupting their markets and increasingly stepping on the toes of the incumbent players.
- **Continued customer appeal:** The total number of neobanking clients has, as predicted, crossed the one billion bar, and now stands at roughly 1.1 billion clients globally – that is an impressive increase of more than 30% in the just 18 months.
- **Climbing revenues:** Industry revenues have grown even faster increasing by ~43% over the same period; on a per client level, average revenues increased from $69 to $75 although with wide dispersion across markets and banks, and still leaving ample room for further growth



Source: Simon-Kucher Neobanking Database | Notes: 1) As of time of analysis - January 2022 and July 2023. 2) Assumption of average revenues of $69 per clients for Jan 22 and $75 per clients for Jul 23 based on analysis of 37 global leading neobanks with available and comparable financial data

While those trends are fairly homogeneous across regions, there are two global regions to highlight: having joined the wave later, digital banks in APAC and Africa are in many cases still in the making or in early stages of their trajectory. And when they launch, they appear to catch up quickly. This is particularly true in markets with large populations and a significant number of underbanked clients like Indonesia, the Philippines, and South Africa. TymeBank (South Africa; growing from 5 million to 7 million clients in 11 months), Bank Jago (Indonesia, from 3.5 million to 7.5 million clients in one year) and DiskarTech (Philippines; reaching one million clients just 38 days after launch) are some of the prominent showcases of the huge opportunities in these markets.

Key challenges ahead

As neobanks mature, priorities are shifting and the magnitude of problems to solve is growing at lightning speed. Whereas founders initially worried about things like UX and go-to-market efficiency, the largest neobanks now must deal with similar challenges faced by their established peers: How do we manage the risks of a growing credit portfolio? How do we appease regulators in the bank's quest for a license or simply to comply with their increased scrutiny? How do we right-size the organization to bring revenues and costs in the right balance?

There are plenty of examples in this young industry that illustrate the potential impact of these challenges. Take for example Marcus, the ambitious speedboat of Goldman Sachs, which suffered significant losses following an unsuccessful venture into the credit card space. Another example is the German bank N26, which at the time of writing this report had to operate under a customer cap imposed by the German banking regulator BaFin. Having a good handle on credit risk, regulatory, and compliance topics is a prerequisite for success. With all these challenges making it more complex to succeed, the pressure is mounting, especially as many neobanks are yet to post a profit.

All eyes on profitability

Neobanks must start delivering on the promises of their business plans. And without further large equity injections, they must generate consistent profits to sustain their growth. Costs and customer base are just two parts of the equation. A clear revenue proposition is the third and now essential component for success.

18 months after stating that only five percent or less of the neobanks were profitable, the number of non-profitable banks still by far exceeds the number of profitable banks. The good news is that there is evidence of a growing number of neobanks who appear to have cracked the code or are getting very close to doing so.

We will dedicate our second chapter to those beacons of light and highlight what differentiates them from the rest. No two neobanks are the same, yet a lot can be learned from those on the right path.

Emerging winners in the race to profitability – and what they do differently

A story of winners and struggling banks

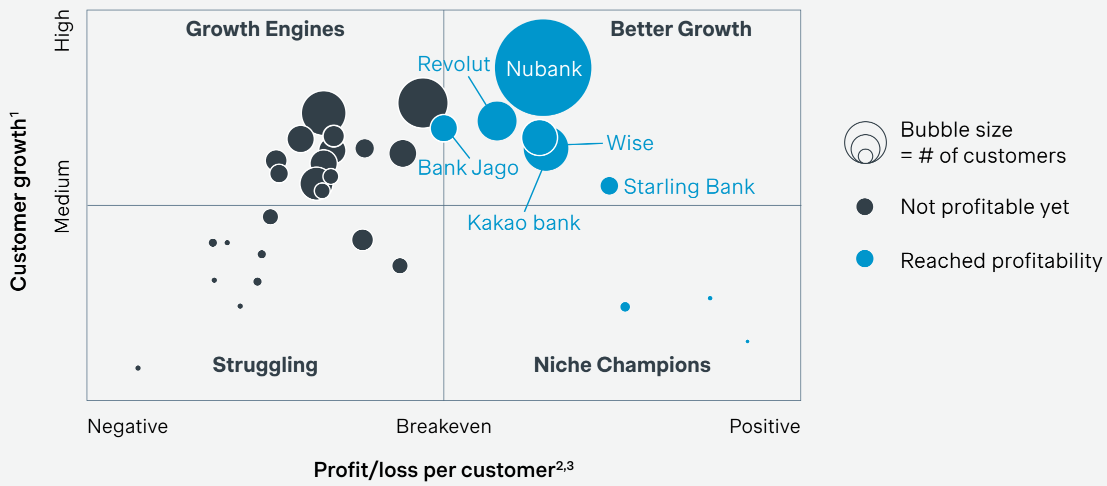
Neobanks have been obsessed with scale over profitability, a concept successfully applied in tech or eCommerce but one lacking proof in the banking sector. As emotional attachment to brands is traditionally lower in banking, and clients often have relationships with more than one bank, monetization of customers that have been lured in with promotional offers tends to be a difficult task.

We are convinced that profitability should be on a neobank's mind from day one – and even pre-launch. Only those that understand how to balance growth and profitability from the early days will come out on top.

To make that concept tangible, we are launching a new measure of success for the sector: Simon-Kucher's Neobanking Profitability Matrix, distinguishing those neobanks which achieved customer growth with a clear lens on profitability.

According to the most recent available public data, only six neobanks globally are positioned in our "**Better Growth**" quadrant, labelling banks that have posted positive EBIT while growing above peer average.

Simon-Kucher's Neobanking Profitability Matrix 2023



Source: Simon-Kucher Neobanking Database based on latest available information as of time of analysis - January 2022 and July 2023. | Notes: 1) Year on year increase in number of clients normalized with log scale 2) Before taxation 3) Adjusted to account for negative numbers. Analysis based on a basket of 33 global leading neobanks with available and comparable financial data

Of those that are outside this quadrant, we distinguish three clusters of banks:

- **"Hopeful" Growth Engines,** achieving above-average growth but still searching for the key to profitability – most of the almost 400 neobanks are in this space, with some approaching breakeven, but many others in need of a more radical shift toward profitability. Interestingly, many of the US banks are in this space.
- **Niche Champions**, which have found a profitable model but need to find ways to scale this model faster; the few examples in this space typically focus their efforts on specific customer segments like SME, which has allowed them to gain deeper penetration quickly but naturally making explosive growth more difficult.
- **Struggling Neobanks**, that remain unprofitable but also showcase below-average growth – a shift of gears or strategy will likely be required but we also expect these banks to be natural takeover candidates in the expected consolidation process.

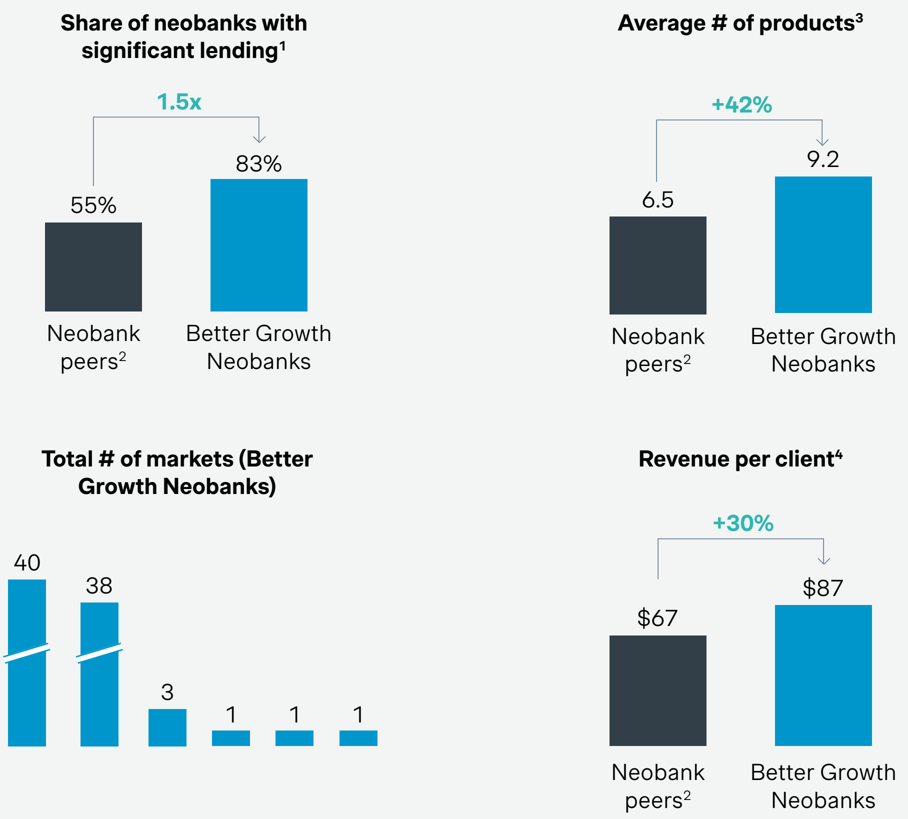
"Better Growth" neobanks – the secret sauce for success

How can you become a "Better Growth" neobank? Well, there isn't just one secret ingredient in the recipe for success. Banks have found different paths, depending on their starting point, size, market maturity, shareholder structure, start year, or availability of funding.

However, analyzing the six “Better Growth” players and comparing them to the wider market, we identified five key success factors:

- **Diversified revenue streams including lending and trading:** Generating revenues beyond account fees or transactional revenues has always been essential in banking to achieve profitability. And neobanks are no different. All of our Better Growth Neobanks have established or are in the process of building a sizeable lending business with the exception of Wise, which traditionally had its focus on currency exchange. Starling Bank, for example, made almost 80% of its fast-growing 2022 revenue pool from interest-linked business. On the contrary, ~50% of the remaining neobanks are yet to seriously offer credit to their clients.
- **Innovation, innovation, innovation:** Yes, we get it, neobanks by definition are innovative. But frankly, there is a huge difference between real innovation and just designing a fancy MVP product or upgrades thereof. Truly pioneering neobanks are launching products on a loop and gradually increasing the value-add for their customers. Think of Revolut, for example. It now offers more than 20 products, including pioneer features like “Stays” or “Experiences”, airline lounge passes and cryptocurrencies. Or take Nubank and its one-of-a kind tokenized loyalty system. All “Better Growth” Neobanks have made true innovation an obvious priority. That said, pockets of innovation of course also exist outside of this group: an example is Zenus, a new Puerto-Rican-based neobank that facilitates US account opening for non-US clients, or Mashreq Neo, that has partnered with the Indian Federal Bank to offer digital non-resident account opening in the UAE. Both are good examples of breaking away from the traditional neobank mantra of “same product, better UX, targeted at digital natives.”
- **Sharp regional focus:** Deep understanding of customer needs, regulatory advantages, undivided management attention, and an edge over global competitors – a localized approach provides many advantages. Better Growth Neobanks have focused their efforts on one or few home markets, really cracking things at home before planting flags elsewhere. Nubank is a good example, spending the first six years focused on excelling in Brazil, where they have now gathered 80 million clients, making it the fourth largest financial institution in the country. Others like Starling Bank or Kakao grew rapidly in their domestic markets for several years before only recently announcing international expansion plans. As every rule has its exception, the stories of Wise or Revolut are noteworthy, as their global footprint has not hindered innovation or profitability.

- **Exploring the edge of analytics and technology:** Is the secret to the Better Growth Neobanks' success their advanced use of (Generative) AI or the ability to monetize technology/data via Banking as a Service and Open Banking offers? It would be too early to make that link. But the banks ranking high on our meter are taking these areas to the next level. We see immense efforts in applying AI to deal with the rapidly increasing customer base or provide Banking as a Service – showcased by Starling's Engine business or MoneyLion's integration of its embedded banking platform Even, now also known as Engine. Once value propositions and customer levels reach a certain maturity among the leading neobanks, the use of new technology will be crucial to maximize monetization potential and minimize the costs to serve those clients.
- **Smart monetization:** The fifth and final differentiator is probably the most important one – the existence of a sound monetization model. Converting smart ideas and innovative products into profits is harder than it sounds. As a rule of thumb, more than 70% of innovative business models typically fail to break even due to a lack of the right monetization model. We have dedicated the following chapter to this important topic and explore pitfalls and success stories – with hands on guidance to drive profits in a tangible way: Profit Hacking for Neobanks.



Source: Simon-Kucher Neobanking Database based on latest available information as of July 2023. | Notes: 1) Defined as more than 1/3 of revenues generated by interest income. 2) Group composed of a basket of 27 global leading neobanks with available and comparable financial data. 3) Includes clearly differentiated products (financial and non-financial). 4) Average for all neobanks within segment excluding SME-only neobanks

Profit hacking – tangible ways to monetize neobanking clients

What we often find when working with fintechs and neobanks is that they at least tick some of the profitability must-have boxes. They are innovative, have branched out into lending and/or investments, focus on one country, and still, they are far from reaching breakeven. So, what is their issue? The answer is straightforward – these neobanks lack a stringent way to monetize their growing customer base.

It seems these neobanks are falling into the same trap as many tech startups at the beginning of the century. They innovate and solve clear pain points but fail to reap the financial benefits.

At Simon-Kucher, we know this story all too well. In 2016, co-author Madhavan Ramanujan summarized his views in the book Monetizing Innovation, providing a playbook for fast-growing companies who want to avoid these pitfalls. As the sector is maturing, four of the lessons are now important for neobanks:

1. Forget product-market fit, aim for a product-market-pricing fit
2. Productize to segments
3. Leverage the power of bundling
4. Master the art and science of pricing

Forget product-market fit, aim for a product-market-pricing fit

We have no doubt that the core principles of product-market fit are well understood in the industry. Most banks have designed their value proposition around clearly visible pain points and are using customer insights to fine-tune their offerings. However, they forget to answer an important question: are clients willing to pay for these improved services? The revenue averages shown in Chapter 1 with only 75 USD per client per annum suggest that this is not – or at least not always – the case.

Let's take a simple example: many of the challenger banks entered the market with "smart accounts", promising better UX, faster and mobile onboarding, the option to set-up sub accounts, and many other features. Did consumers like what they got? Absolutely. But did they open their pockets to pay for it? In our experience, they often didn't value the services enough to pay a substantial monthly fee for them. Or were banks simply too excited to grow, with "finding a way to charge" low on the priority list? Either way, millions of clients today get to enjoy true value-added services for free.

To turn this around, neobanks need to seek a product-market-pricing fit. This means designing their products around the price, not only understanding which products and features will resonate in the market but also where clients will open their pockets and pay for them.

Productize to segments

In neobanking, many still cluster clients by size, e.g., "Mass Retail," "Affluents," "Wealthy," and "Corporate." But neobanks face the same challenges as any other digital startup. Targeting large and diverse segments like "Digital Natives" is difficult when you have a limited marketing budget.

A prime illustration is Uber. In March 2009, Uber (then known as UberCab) launched its pioneering "black car" ride service model, primarily catering to those in search of convenient, on-the-spot transportation. Uber initially honed in on one clearly defined segment before expanding its horizons to e.g. UberX, offering a more budget-friendly alternative to the upscale black car service, and UberEats, capturing the attention of busy millennials seeking convenient dinner options.

Neobanks can embrace this strategy by identifying segments that lack access to specific financial services. For example, one neobank in Latin America built their launch offer around easier payment options for international subscriptions like Netflix, eliminating accessibility barriers. Other paths include resonating with groups exhibiting distinctive preferences, like "Crypto-Trading Enthusiasts," or engaging with clearly defined sub-segments with comparable needs like "Freelancers."

Leverage the power of bundling

What could neobanks learn from the sale of Big Macs or Whoppers? The answer: bundling.

Fast-food chains exemplify the concept of bundling perfectly by creating enticing value meals from burgers, fries, and drinks, raising the perceived value for their clients while provenly growing revenues for the restaurants. However, bundling can apply to almost any industry – and neobanks are no exception. Smartly packaging products into well-crafted bundles can enable neobanks to add more value compared to standalone offerings.

The current environment provides several opportunities where bundling could be a part of the solution:

- How can neobanks combine accounts with high-yield deposits, harnessing the pull effect of deposits while carefully sidestepping the potential for cannibalizing low-rate funding?
- What's the ideal nexus between crypto trading and brokerage accounts – a unified package or two distinct offerings with separate pricing?
- How should neobanks sell value-added features that would perform better outside of a bundle?

Some neobanks have already started experimenting with bundling. For instance, Acorns in the US has been offering banking solutions, investment options and even children's access under one, streamlined subscription fee.

The good news is that smart bundling isn't born of guesswork. Rather, it thrives on a systematic and scientific approach. Our experience shows that getting this one concept right can drive revenue figures upward by an impressive 20-40%.

Master the art and science of pricing

Pricing is much more than deciding whether to offer a basic account or card for 3.99 or 4.99. You need to delve deeper, not just considering what you charge, but more importantly, how. It's about the metrics that underpin pricing decisions – spanning transaction-based calculations, volume-driven models, and loyalty rewards.

Think about the surge of streaming platforms. These businesses witnessed exponential growth by taking one-off movie rentals and transforming the idea into seamless, all-inclusive experiences via subscription models.

The world of banking mirrors a similar trajectory and a growing number of neobanks is testing subscription models to monetize their client relationships. An innovative example is US-based Aspiration, which packages banking- and climate- related benefits into a premium bundle for a small monthly fee. Our recent consumer insights in Europe illuminate a prevailing affinity for all-encompassing banking fees – a win-win where clients perceive enhanced value while banks reap higher net revenues.

Even greater potential unfolds when neobanks enter the domain of differentiated pricing. This strategy is most applicable for deposits and loans and requires access to large data sets.

Today we already see leading challenger banks and fintechs using the masses of information they gather to differentiate prices for loans. By scrutinizing factors like application timing, loan purpose, engagement channel, and customer lifetime value, these pioneers offer an array of differentiated prices, with a pricing landscape that resonates with the individualities of each customer.

Profit hacking pillar	Key elements		
Achieve a product-market-pricing fit	**Design product around price** ...not the other way around	**Understand willingness to pay** ...by explicitly addressing this area in consumer research	**Develop smart launch plans** ...not giving away your most value adding features for free
Productize to segments	**Segment your target base** ...identifying well-defined clusters with homogeneous needs and willingness to pay	**Focus, focus, focus...** ...on one or few segments at first, before expanding into other areas	**Adapt your marketing strategy** ...with tailored promotions, channels, messages, all according to the chosen segment(s)
Leverage the power of bundling	**Create smart product bundles** ...based on detailed insights which features and products to package to create maximum value	**Monetize your value add features** ...positioning those offers that perform better outside of bundle	**Use behavioral economics** ...to constantly test and improve how your bundles resonate in the market
Master the art and science of pricing	**Develop a pricing strategy** ...defining not just how much you price but also how you price	**Test alternative pricing models** ...benefitting from the power of subscription models and All-In elements	**Launch dynamic pricing** ...using all available data to personalize pricing for loans and deposits

These monetization levers are often underestimated by neobanks, but our experience shows that getting them right is a fundamental prerequisite to fast profitability. Learning from the best and making monetization a CEO priority should reap rewards quickly.

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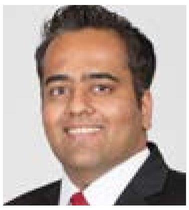

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