



# TRANSFORMATION FROM TRADITIONAL TO DIGITALISED TO NEO BANKING FOR INCLUSIVE FINANCE



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## Synopsis

*The Findex 2021, published by the World Bank, revealed that 1.4 billion people were unbanked, and most of them are poor and women living in rural areas. Neo Banks, driven by advanced digital technologies are trying to accelerate the process of banking and rendering related auxiliary services. But the present partnership*

*model between digitalised traditional banks and Neo Banks may not yield the needful result at desired speed without a licence. This paper first aims at demystifying the myth about neo banking and then suggests a set of strategic themes with dual approach for accentuating the progress of neo banking for achieving inclusive finance for inclusive smile.*

## Introduction - The Axiom

There are several views on the question when electronic media and internet started being used for delivery of banking services. One such view is that the first ever delivery at home was started in 1981 by a few large banks in New York city. Those banks, viz., Citibank, Chase. etc. They used a unique system called 'Videotext. The Stanford Federal Credit Union started internet-based banking services for the first time in 1994<sup>1</sup>. In their research paper Sanli and Hobikoglu (2015)<sup>2</sup> mentioned that internet banking processes started since 1990. This almost coincided with

*Image Source:* <https://www.indiatimes.com/worth/news/what-are-neobanks-and-how-do-they-work-580258.html>

commencement of the first world wide web or Web1.0. ICICI Bank is the first bank to provide internet-based banking services in India from 1996.

Thus, it took about two and a half decades, since computerisation of banking transactional records, for internet-based banking to commence. Two major reasons for such a long gap inter alia are delay in development of enabler telecommunication network and software for computing platform based two-way transactional communication and powerful frontend handheld device App for customers. Advent of Web 2.0 in 1999 accentuated proliferation of banking through internet.

### Axiomatic Vision

But the axiomatic visionary statement on digital age banking was pronounced even before the dawn of platform economy riding on Web2.0. In 1994 Bill Gates<sup>3</sup> made a groundbreaking statement, “**Banking is necessary, banks are not.**” The entire world was taken aback. It took another about two decades to appropriately assimilate and appreciate what he envisioned and realise how it would be possible to achieve the directional guidance embedded in it. The visionary statement of Bill Gates got revalidated during the period of Covid-19 pandemic. During about three years of dreadful experience people across the world felt and appreciated the critical need for delivering/receiving banking services to and by all across all levels and remote locations.

The genesis of pathbreaking changes in the form of mobile banking for all till the lower rank of societal strata lie in the aforesaid visionary statement of Bill Gates. Customers want banking facilities from anywhere at any time. With extensive digitalisation of banking operations, the world witnessed onset of the era of self-banking without any physical intervention by any banker. Continuous reduction in digital divide in countries like India accentuated the process. Citizens are now using the digital platforms and digitalised processes provided by banks. Those are securely accessible by mobile devices from any location in a seamlessly connected network from banking perspectives. The focus has continuously shifted from:

- ⊙ Traditional customers’ delightful experience at the branch
  - ⊙ To the digitalised platform for branchless banking, and then
  - ⊙ To customers’ delight right from on-boarding to cashless banking from anywhere at any time
- in a regulated environment with due measures for

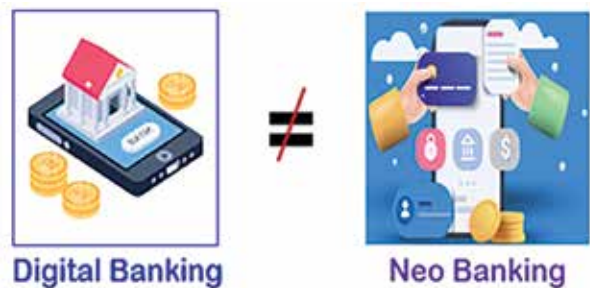
privacy, data safety and security.

### Objective

This paper has been written with the assumption that it is essential to further intensify efforts for transforming neo banking into a financial revolution. Otherwise, bringing 17% unbanked global population under banking network will inordinately be delayed. With this in view efforts have been made to first demystify the myth between digitalised banking and neo banking. The present status of neo banking across the world and the pace of progress have also briefly been narrated. Finally, certain strategic themes have been recommended, identified from a research study jointly done by the author and his co-researcher, which should be adopted for proliferation of neo banking.

### Demystification of the Myth and Neo Banking

Digitalisation of banking operations, as has been narrated towards the end of the above introductory section, should not be construed as the process of ‘Neo Banking’. Therefore, at the outset there is a need for demystification of the myth that Digital Banking is not equal to Neo Banking.



Neo Banks (NBs) challenge legacy banking systems, with or without having any banking licence, on all matters of achieving speed, quality of services and thus customers’ delight. They aim at providing unique and innovative banking solutions through digital platforms. NBs are by nature user friendly digital banks without any form of physical touch point with customers right from the very inception. Therefore, they don’t need digitalisation by converting existing processes of the past. They provide seamless banking experience at much lesser cost on transactions and higher returns on investment. Thus, NBs are disrupting digitalised legacy banking systems of traditional banks. They have generated astonishing sensation among customers particularly of younger generations.

The following Table provides a comparative analysis of feature of Neo Banks digitalised Banks:

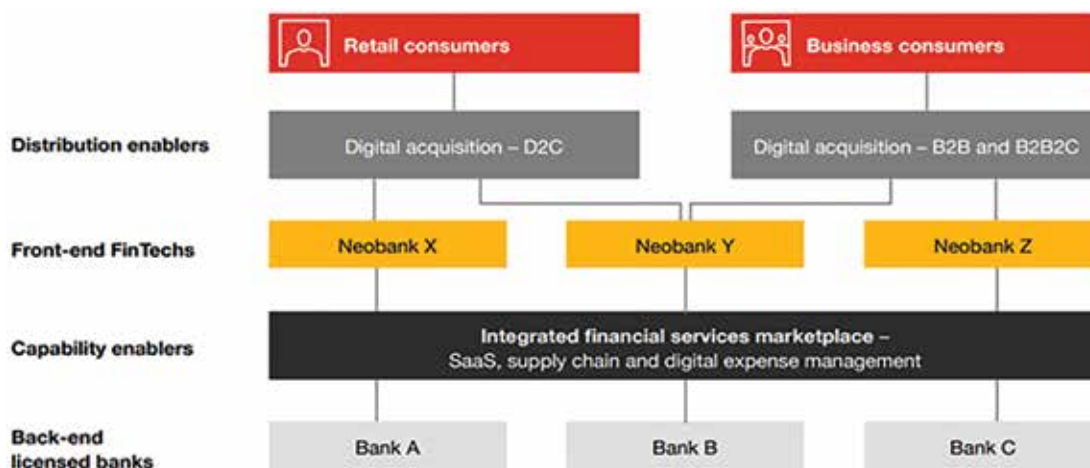
Neo Banks and Neo Banking	Digitalised Banks and Legacy Banking
1. Born in minds of innovators and first- generation entrepreneurs and startups of digital age.	1. Inherited hundreds of years old legacies evolved with dynamics of changes in economic and societal ecosystem.
2. No physical branch and touch points with customers.	2. Cannot wish away branches and physical customer touch points per policies and SOPs.
3. Challenge legacy systems and design innovative ones remaining within the boundaries of regulatory frameworks.	3. Digitally transform traditional services for delivery through digital channels.
4. Front to back end seamless innovative approach for delivery of services to customers	4. Back to front end conversion approach for digitalisation based on traditional banking policies and SOPs.
5. Minimise costs with advanced FinTech applications, RPA and touchless banking for people, documentation	5. Cannot avoid costs due to network of branches, manpower for physical contacts in addition to costs for digitalisation
6. Two types of Neo Banks <ul style="list-style-type: none"> <li>▪ Full stack touch less digital banking services with regulator’s licence, and</li> <li>▪ Front end banking services partnering with traditional licensed banks.</li> </ul>	6. Continues with old banking licence and follows regulatory guidelines for digitalisation.

**Digital Banking Solutions of Neo Banks**

NBs, which are not full stack licensed banks, position their digitally designed layer of service platforms in between both retail and business entity customers and the traditional licensed banks. NBs wrap up those traditional banks with their digital service facilities. They follow several channels like NB2C, NB2B and NB2B2C and finally end up with the one or more traditional licensed bankers for those monetary transactions for which regulatory license(s) is required.

NBs deliver all service functions in due compliance with all relevant provisions of all regulators concerned with the transactions, e. g., RBI, IRDAI, SEBI, etc. Frontend compliance of regulatory provisions by NBs are essential, otherwise the finally recoded transactions in actual bankers’ books would be considered as non-compliant. The features of Neo Banks and their structural set up for wrapping up traditional licenced banks with whom they partner can be explained through the following graphic:

**Operational Architecture of Neo Banks Without License**



Source: <https://www.pwc.in/assets/pdfs/consulting/financial-services/fintech/publications/the-evolution-of-neobanks-in-india.pdf>

The above graphic indicates that NBs position their digitally crafted service platforms in between both individual/retail and business customers, and their Traditional Licensed Bank Partners (TLBPs), whom they wrap up with digital service facilities. NBs follow several channels like NB2C, NB2B and NB2B2C and finally end up with the one or more TLBPs for those monetary transactions which require regulatory license(s). They perform the following functions in due compliance with all provisions of all concerned regulators, e. g., RBI, IRDAI, SEBI, etc. Like any other digitally driven startups NBs adopt the following approach for designing neo banking platforms:

- ⊙ Identify latent demands of customer segments they intent to serve and TLBPs,
- ⊙ Critically evaluate with pervasive analyses of feedback from target customers about their pain points in banking even after using digitalised platforms provided by TLBPs,
- ⊙ Ideate digital solutions, build the frontend App, and backend platform with customer-centric strategies by cerebral applications of technologies, including OCR, NLP tools, etc.,
- ⊙ Predominantly focus on providing delightful experience to customers in mobile banking and smooth flow of transactions by seamlessly integrating their platforms with the digitalised banking systems of TLBPs,
- ⊙ Total regulatory compliance at all steps and in all aspects of solution designing and service delivery to both customers and the TLBPs.

The above approach indicates that NBs adopts a 'Front to Back' approach in their solution designing because the uniqueness of their customer focussed mode and process of service delivery determines their competitive advantages:

### Banking and Auxiliary Services by Neo Banks

As is evident by now NBs provide services to both retail and business customers and TLBPs as an intermediary and solution enablers for the later. They provide one or more of the following major banking and transactional services:

#### KYC, Onboarding and Account Management

NBs serve TLBPs by onboarding new customer post completion of KYC formalities, including renewal of KYCs, in due compliance with regulatory provisions.

The required soft copies of documents are instantly uploaded by the prospective customers. Those are read using OCR tools and fed into digital forms using NLP based cognitive tools. Such digitally documented and signed forms with customers' consents are passed on to TLBPs for adoption and storage.

#### Multiple and Forex Account Management

NBs provide facilities for multiple bank account management, including accounts in foreign currency in countries where the same is permitted irrespective of being full stack licensed NBs or in collaboration with their TLBPs.

#### Payment Banking

One of the major services of most of the NBs is rendering payment banking services. They connect the payers from both retail and corporate customer groups, with the payees'/recipients' banks for transfer of funds followed by a confirmation sent to each payee through mails and/or messages. A word of caution here is that Unified Payment Interface or UPI of India is just a platform for connecting all parties and not any banking facilities.

#### SaaS for Business Operations

NBs also render non-banking services to MSMEs. Their platforms function as a marketplace for 'Software as a Service' (SaaS) and are seamlessly connected with the recipient clients' respective computing systems through APIs. The pass on all transactional records through wallets for each customer. For this NBs maintain 'Digital Library for Business Rules' of each customer. The end lag of such SaaS based transaction is payment or collection as appropriate. Various operating transactions which are covered through such SAAS:

- ⊙ Supply chain management, including raising of invoices, financing, etc.,
- ⊙ Authorisation of transactions for payment banking,
- ⊙ Preparation of payrolls and disbursement of salaries and wages to employees,
- ⊙ Expense management,
- ⊙ Management of working capital, insurance policies, investments in financial securities and cryptocurrencies, etc.
- ⊙ Promotion of products and business transaction management by providing an additional virtual marketplace and eCommerce for MSME and other business customers,

- Issuance and management of freebies, credit/discount cards, etc.

ICICI Bank's DigitalLite services in India is one such platform for supply chain financing. One can know more about the services from a blog in dashdevs<sup>4</sup> Neo Banks have the following two distinct yet inter-linked layers in their digital platform:

- I. The First Layer has two distinct yet integrated digital solution-based facilities for:
  1. Ensuring regulatory compliances at each step of rendering digital banking services, and
  2. Wrapping up TLBPs with seamlessly integrated digitalised facilities for delivering banking services related functions outsourced to them.
- II. The second layer contains digital tools for:
  3. Payment Gateways with facilities for omni-channel payment processing,
  4. Providing access to other digitally operated platforms of various financial service providers, insurance companies, global forex brokers' solutions, etc.
  5. Facilitating investment management transactions by or on behalf of customers, etc.

### Proliferation of Neo Banks and Customers

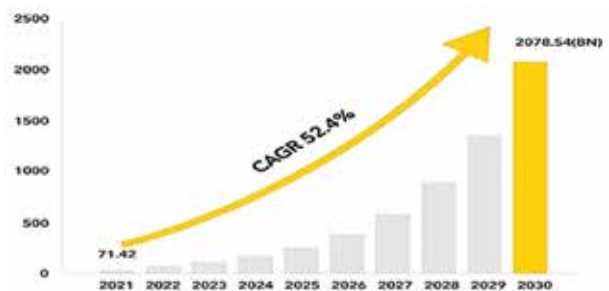
According to a report on FINDEX 2021 of World Bank<sup>4</sup> out of about 8.0 billion global population about 1.4 billion (17.3%) adults were lying unbanked. Most of such people are residing in rural areas and hard to reach. However, digital divide between urban and rural areas is on a reducing trend due to establishment of extensive telecommunication network. Therefore, NBs are in a better position than traditional banks to bring rural and unbanked citizens under banking network. Efforts of NBs for this are being seen around the world, including India.

In India NBs are increasingly becoming a popular group of financial service providers across all societal strata. They are also being preferred by eCommerce and online business platforms. As per StartupHRtoolkit<sup>5</sup> efforts of twenty-one major Neo Banks to be watched. Names of a few of those NBs are Fi Money, Frayo, RazorPay, Jupiter, Kotak811, Mahila Money, OcareNeo. None of them are full stack licensed banks but are integrated with the traditional bankers. Enough

information about Neo Banks is available in cyberspace. One such webpage is of SDK Finance<sup>5</sup> which readers may consider visiting to get similar information about developed countries.

Tamas Kadar, CEO of SEON<sup>6</sup> has quoted in his recent article from the prediction by Statista Market Insights, a globally reputed organisation stating that ".... Total transaction value of neobanking will reach \$2,6 trillion by 2027. It also predicts that 2023 will see a user adoption rate of 15.5% rising to 22.8% over the next five years."

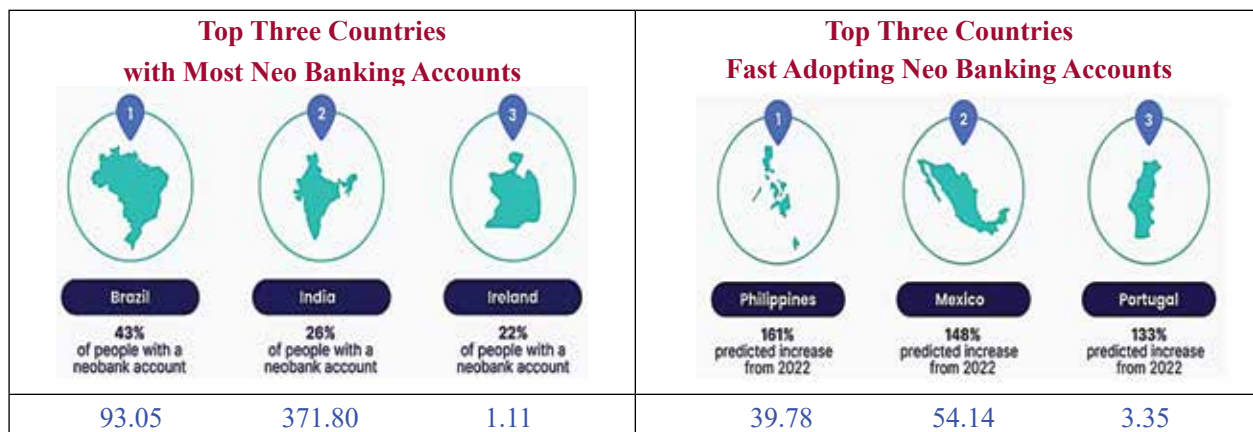
According to Igor Tomych, CEO at DashDevs, Fintech Garden<sup>7</sup>, ".... in 2022, the global neo banking market boasted a valuation of \$79.1 billion, and within just one year, it soared to a staggering \$118.51 billion. .... By 2030, experts predict that the global neo banking market will reach an astonishing \$2078.54 billion, maintaining an impressive CAGR of 52.4%." This has been iconically presented in the trailing graphic with numbers in USD billion:



Source: <https://dashdevs.com/blog/how-to-build-a-neobank-using-vendors-platforms-or-apis/>

The following two graphics are indicators of the present volume of customers of NBs and the speed at which they are multiplying. The numbers provided in the second row of the following graphic are number of neo banking accounts in millions. The graphics reveals that:

- India is the second country with most neo banking accounts if expressed as a percentage of total population. As of September 2023, 26% of Indian population is having Accounts with NBs. Brazil is the first and Ireland is third country with 43% and 22% respectively,
- Annual rate of growth of number of citizens being covered by accounts with NBs is the highest in Philippines with 161% till September 2023 compared to the same period in 2022, followed by Mexico and Portugal with 148% and 133% growth respectively.



Source: <https://seon.io/resources/neobanking-index/>

Actual magnitude of NB Accounts of Indians is about four times of that in Brazil at 371.80 million, but the percentage is lesser than Brazil because total population as denominator is higher at around 1.40 billion. Thus, India has the highest number neo banking accounts. Similarly, Mexico’s number of NB accounts at 54.14 million is higher than that of Philippines at 39.78, albeit rate of growth of the later is higher. Readers may study the report published by SEON<sup>6</sup> for getting similar statistics of top ten such countries under both the groups of statistics from across the world.

**Journey of Digitalised Banks to Neo Banks - Strategic Plans and Actions**

Many of the large, digitalised banks around the world have adopted neo-banking specific strategies for further digital transformation to gain sustainable competitive advantages in their journey towards prosperity. The major objectives are enlarging customer base, minimising / zeroing down physical touch points with customers, enhancement of speed in service delivery and optimisation of operating costs. For this Many of them are partnering with NBs, while the balance are either engaging/acquiring Startups and/or using their own in-house ICT and digital technology teams for development of innovative software and platforms to attain the features of Neo Banks.

Roy and Basu, the latter being the present author, (2021)<sup>8</sup> through their extensive research study of forty-eight digitalised banks across the five continents had finally selected eight banks who have adopted such strategies. They have traced out the following major strategic themes of those eight large banks in their journey from a digitalised bank to a full stack Neo Bank with banking license being already available to them:

- To be the market leader in digital transformation for understanding customers better, make more

informed decisions, and strengthen control functions,

- Work for financial and digital empowerment for millions of individuals and business entities by innovative applications of advanced digital technologies (DTs) for service deliveries,
- Expand and enhance data capabilities to help risk-enabled performance management (REPM) for achieving more customers’ delight and be a proactive member of global digitalized business ecosystem,
- Create platforms to support entrepreneurial community by setting up national networks of digital technology labs, incubation of highly potential, startups with co-working spaces, mentoring and providing access to cutting-edge technologies to rapidly prototype new product ideas,
- Focus on risk-enabled operational efficiency (REOE) by forming enterprise resiliency units as a part of core enterprise resiliency strategy,
- Modify organisational structure and drive change management efforts for persuading staff members and other stakeholders that the **Bank is a new Digital Company** with a digital client base, and
- Measuring ROI from digital transformation in qualitative returns\_such as hackathons, agile project management and collaborations to bring about a cultural shift in the organization.

Readers may agree with the author’s point that digitalised banks around the world shall soon be able to remove the financial divide and achieve inclusive finance by bringing those 1.4 billion unbanked people under banking network across all countries. But in this mission, they must adopt the aforesaid strategic themes

in varying degrees depending upon internal realities of individual banks. The option for implementation may vary between partnering with Neo Banks or transforming themselves into Neo Bank through internal efforts for advanced digital transformation. The later seems to be the option if Neo Banks are not given licence of full stack banking.

### Conclusion

In the immediately preceding paragraph, the author has written with conviction that specific strategy driven proliferation of neo banking is essential for attaining success in inclusive banking and inclusive finance for inclusive smile. The clarion call is to never ever leave behind rural poor people and women. Digital technologies by themselves cannot achieve all these unless human efforts are directed towards transforming traditional banks through objective oriented change management with the mindset of applying digital technologies powered by a set of well-defined strategies.

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