Challenger banks and the future of digital banking

September 2021

pwc

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Message from PwC

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The banking industry has undergone momentous transformation in recent years as connected technologies unlock new financial and non-financial opportunities. The dawn of the twenty-first century witnessed an important and significant transition as the rapid growth of global internet users fuelled the rise of internet banking services.

Digital banking transformed from the early 2010s with the widespread use of smartphones and the sector witnessed the rise of new banking models. These early online banks were largely seen as additional services or new distribution channels for existing incumbent banking operators.

The rapid rise of smartphone penetration, economical access to data and the growing middle class also gave fillip to a connected digital economy. Major digital consumer-tech platforms such as e-commerce and mobile food delivery brands have inspired the expectations of providing seamless digital services and personalised customer experiences. Customers are increasingly expecting a superior experience across their journey from digital interfaces, products and services, and personalised digital encounters, resulting in changed expectations from their banking services as well. This has necessitated a fresh repositioning for existing banking players as they shift to meet the growing digital needs and expectations of customers, and often require front-to-back-end digital transformations.

As the digital banking landscape expands in the coming years, operators will need to consider not just how to win in this market but also how to develop strategies that suit their businesses. This fresh landscape of digital expectations has driven the rise of new banking models that form the focus of this report. These challenger banks are increasingly emerging from the innovative incumbent banking players and FinTechs as well as non-financial institutions looking to monetise their customer bases. They have also realised the benefits of the connected digital economy to tap into digital banking frameworks and adopt collaboration and partnership strategies to holistically meet ecosystem requirements, and sustain customer engagement and business growth.

We are grateful to the Associated Chambers of Commerce and Industry of India (ASSOCHAM) for identifying such a relevant theme. We hope that readers would appreciate this report as much as we relished researching for its preparation and delineating our thoughts in it. We hope you find this report to be a good and insightful read. Please reach out to us with your thoughts and feedback.

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1. Understanding challenger banks

Challenger banks are tech-led neobank start-ups or non-financial services that are pivoting into financial services as well as digital-only offerings by incumbent banks. Such banks have grown significantly in India and worldwide in the last few years. These digitally driven set-ups are competing against traditional banks and offering superior customer experience and hyper-personalised services and offerings. They are primarily focusing on various niche customer segments that are mostly unbanked or underbanked, particularly millennials. Instead of targeting the larger customer segments of traditional banks, these players are trying to fulfil the needs of the previously ignored segments and are being quite successful in attracting new customers.

a) Gaps in traditional banking models

It is important to identify some of the existing gaps in traditional banking models which have enabled challengers banks to grow rapidly over the past few years:

Complex and non-customised financial products

The wide range of financial products offered by traditional banks are designed to cover a larger customer base and not customised to meet specific needs. Challenger banks have been able to differentiate themselves by providing personalised products to customers along with superior customer service. In an age of hyper-personalised advertisements and services, traditional banks are yet to tap into tailored products catering to a specific user base. For example, the banking needs and requirements of customers in the age group of 12–14 years will vary vastly from that of an experienced grey-collar worker. Challenger banks have successfully created user journeys by mapping their requirements into customised products.

Connectivity and reach

The cost structures of traditional banking models – with heavy reliance on physical touchpoints and manual processes – make it uneconomical for them to reach and serve certain customer segments, resulting in them remaining underpenetrated. For example, approximately 27–29 million micro, small and medium enterprises (MSMEs) in India have limited access to formal credit and thus rely on informal sources and shadow banking.[1] Challenger banks have been able to address this gap through a combination of digital-first channels and services as well as ecosystem partnerships.

[1] https://www.livemint.com/opinion/online-views/we-must-study-the-msme-credit-gap-before-we-can-fix-it-11620320723543.html

Customer experience

The user interface and user experience provided by the products and services of traditional banks are inferior compared to those of other tech companies. While banks have always been at the forefront of technology disruption, they are currently playing catch up and moving from manual to technologically automated processes. With the pace of technological advancement swiftly affecting how customers expect their experiences to be, traditional banks will need to provide experiences that are instant, frictionless, contextual and holistic.

Awareness and engagement

Traditional banks have a range of financial products suited for various types of needs. However, the lack of understanding of financial products is a key impediment to customer acquisition. A number of challenger banks and FinTechs have utilised educational initiatives to create awareness, build brand trust and drive demand. A leading discount-brokerage platform in India saw an uptick in usage due to an educational module that it built for its users.

Recent global trends show that traditional banks have realised the power and potential of disruption by internet-first companies in the last two decades. Some of them have launched their versions of digital banks (which we refer to as incumbent digital banks). These incumbent digital banks work on a digital-only approach, leveraging the reach and brand presence of traditional banks, and utilising and building on existing banking technologies. Additionally, there is a separate set of growing retail-focused tech companies that are expanding from their core value offerings to encompass services like neobanks (we refer to them as adjacent expanders). The umbrella under which we categorise neobanks, incumbent digital banks and adjacent expanders can also be termed as challenger banks.

Challenger banks

NeoBanks

FinTechs providing banking services in partnership with licensed banks at the back end or having their own licences.

Incumbent digital banks

These are set up by established players having both online and offline presence.

Adjacent expanders

These are retail-focused tech companies that are expanding from their core value offerings to encompass services like those offered by neobanks.

Source: PwC analysis

b) Outlook of regulators

The concept of challenger banks and the associated business model has found a strong footing in Europe. They have been operational for more than a decade and are closely regulated, resulting in matured operations in their headquartered countries and rapid expansion of their footprint in other geographies. While the US does not seem to have a standard federal law regulating challenger banks, various states have licensing regimes for regulating their operations. The direct regulations prevailing in both the US and UK are stringent and comprehensive enough to encompass the entire customer journey, including onboarding, servicing and termination. At the same time, such regulations have been equally adaptive to the newer business propositions that challenger banks keep developing regularly. This is presumably one of the core reasons for the success and ever-increasing numbers of challenger banks in the US and UK.

Asian countries gradually followed suit and have steadily picked up pace in regulating and promoting challenger bank set-ups in the last few years. However, the approach in regulating challenger banks has varied amongst Asian countries. While countries like Japan, Singapore, Taiwan and Malaysia have chosen to directly regulate challenger banks and issued digital banking licences to multiple players, India has been cautious and is predominantly indirectly regulating FinTechs offering digital financial products.

Regulatory framework in India

India's financial services sector, especially the banking industry, is a heavily regulated one. Virtual-only challenger banks are yet to be developed extensively in India. Digital financial products in India are usually offered by financial institutions themselves or established FinTech and adjacent expander entities (such as payments banks, neobanks and e-commerce players). Furthermore, the concept of a completely digital banking set-up that offers products and services similar to the current brick-and-mortar banks is yet to get regulatory approval. When the Reserve Bank of India (RBI) introduced the concept of payments banks in 2014, it was believed that India was gradually moving towards a completely digital banking era. However, payments banks in India are required to have some sort of a physical set-up embedded in their operations. Hence, the digital banking journey in India has evolved gradually compared to other Asian countries.

Indian FinTechs (neobanks) have to engage with regulated banks and financial institutions to offer financial products/services to customers due to the absence of enabling regulations that allow them to offer deposit and lending products (on their own books). The regulatory obligations are typically passed on to FinTechs because of such tie-ups and resultant contractual arrangements. Thus, from the regulatory standpoint, while the regulated entity is responsible for the products offered through FinTechs, both the entities are to ensure compliance with regulations.

In addition to banks, FinTechs also tie up with non-banking financial companies (NBFCs), prepaid payment issuers (PPIs), insurance companies, etc., to digitally offer their products in the market. Entities can seek individual licences to operate as NBFCs, PPIs, investment advisors, etc. Such licensing is relatively easier to procure compared to a banking licence and enables the respective entity to completely operate digitally. Currently, there is no regulation in India that enables issuing a single licence (akin to that of a bank) for selling multiple financial products digitally.

FinTechs are also taking up business correspondent/outsourced third-party service provider roles. Such service-provider roles are becoming increasingly noticeable with burgeoning customer bases, enhanced interests shown by private equity (PE) investors, multiple use cases, etc. Simultaneously, with the recent regulatory measures introduced by India's financial regulators encompassing regulatory sandbox, video KYC, account aggregator norms, etc., it seems as if they have started taking initial steps to lay the foundation of creating a regulatory environment that is feasible for the formal establishment of challenger banks in India. It will be interesting to witness the interplay of the growing access to digital financial products (for Indian customers) with the evolving regulatory framework.

c) Impact of COVID-19

A significant number of businesses were impacted during the initial months of the lockdown announced in March 2020 as the number of infections increased across India. While some sectors like aviation, hospitality, tourism and physical retail were affected due to the restrictions, others like healthcare, pharma, e-commerce, food delivery and payment processors witnessed new growth opportunities through digital-model pivots. Although some customers were already using digital mediums to transact, purchase and process services, a majority of new customers were onboarded due to the limits imposed on mobility and unavailability of other channels. Such customers have now been introduced to more convenient online digital channels and companies offering such services are aiming to create a habit loop to help during the transition and engage continuously with them.

The onset of the pandemic also accelerated the need for rapid tech-led transformation for incumbent banks and financial services players. They had to undergo accelerated tech transformation to minimise the impact of the pandemic and continue providing services to end customers. They also had to build and migrate to a remote working environment within a short time period. Urban bank branches reported up to 50%[2] reduction in footfalls, leading to a surge in the demand for major digital banking services among customers. The growing demand for COVID-sensitive customer experiences facilitated via digital channels led to increased requirements for digital onboarding, contactless services, and engagement tools.

Some of the key impacts of COVID-19 on the banking sector are discussed below:

Increased customer willingness to bank through digital channels

Some banks have recently introduced video KYC and adopted digital-only onboarding processes, transaction facilitation and servicing. As customers become more comfortable with remote interactions, banks have started using alternative channels like chatbots and messaging services to connect with them.

Greater penetration into semi-urban and rural regions

Semi-urban and rural regions reported increased usage of digital payment methods, particularly point of sale (POS) machines, biometric devices for Aadhar-Enabled Payment System (AePS) withdrawal, and QR code for Unified Payments Interface (UPI) payments.[3]

Focus on cyber security and compliance to tackle fraud

The CEO of one of India's largest private banks said that they had witnessed an increase in fraudulent activities during the pandemic.[4] Banks are upgrading their cyber security infrastructure to minimise associated risks.

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2 https://www.thehindu.com/news/cities/puducherry/social-distancing-leads-to-drop-in-footfall-at-banks/article31158550.ece
3 https://www.freepressjournal.in/business/digital-banking-impacts-indias-rural-economy-heres-how
4 https://www.moneycontrol.com/news/business/covid-exposed-indian-banks-to-increased-risks-in-digital-transactions-uday-kotak-6350591.html

Advanced analytics and gamification

Banks have looked to supplement digital customer journeys with tailored and contextual service delivery through insights driven by analytics. Delivering these services through gamification has served the dual purposes of creating financial awareness and sustaining customer engagement.

Value in partnerships

Banks have also come to realise the benefits of capitalising on smart partnerships to sustain and expand their businesses, and develop swift go-to-market strategies. They have formed both distribution and capability partnerships to reach customers seamlessly and also innovate on products. For example, an Indian small finance bank has tied up with a leading payments player to drive new customer acquisition and cross-sell products.[5]

5 https://www.telegraphindia.com/business/google-partners-with-equitas-small-finance-bank-to-offer-time-deposits/cid/1829172

2. The challenger bank model

Challenger banks are institutions that look to disrupt the larger and more established banks by focusing on digital technologies and customer experience. They can be new-age start-ups set up over the last decade, digital arms of existing traditional banks or existing ecosystem players who can pivot themselves into providing banking and financial services. Challenger banks cater to retail and SME customers who are generally underserved by traditional banks and leverage mobile-first technology to differentiate themselves by introducing innovative new products and providing superior customer service.

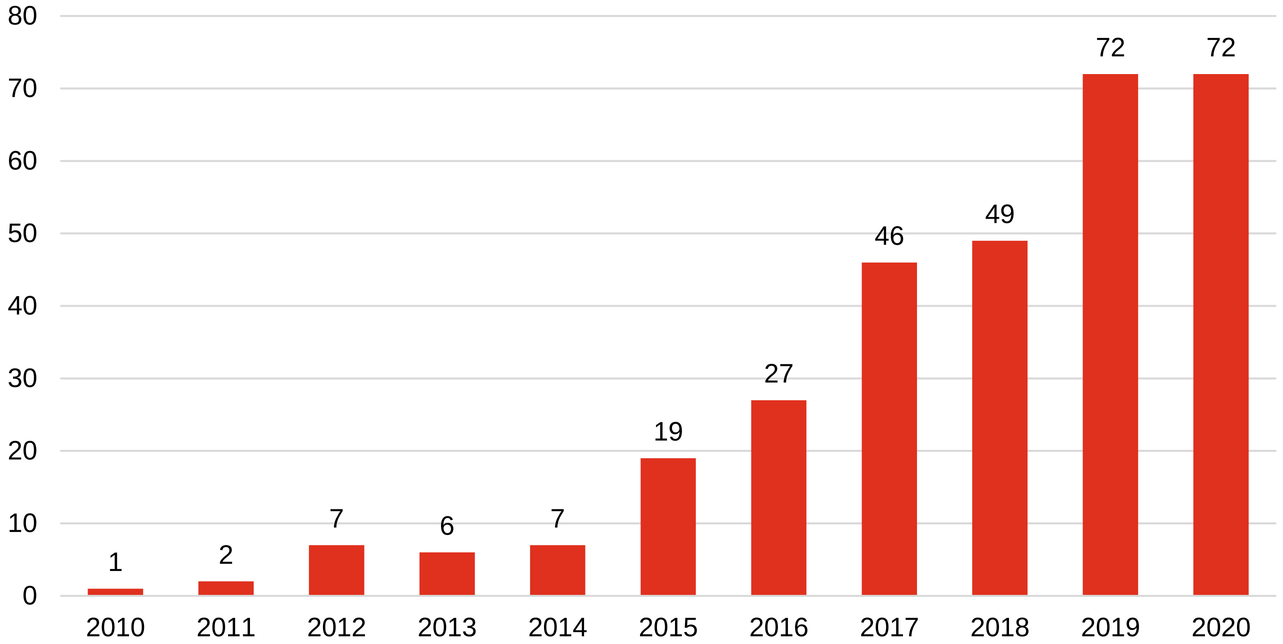
A number of products/services offered by challenger banks are designed for specific customer segments. Such banks predominantly operate online, resulting in lesser paperwork, real-time services, lower operating costs and better customer experience. They resemble technology firms with their agile operations and integration with various partners, helping them in reducing the cost of acquisition and enabling them to penetrate deeper into their target segments.

a) Global and India trends

Global trends

Challenger banks have expanded strongly across geographies in the past one year. The figure below shows the number of challenger banks launched worldwide over the last decade.

Number of challenger banks launched worldwide (2010–2020)



Source: Statista

While the COVID-19 pandemic adversely impacted all major sectors worldwide, challenger banks have grown steadily. The seven leading challenger banks operational in the US had a combined user base of 39 million in 2020, approximately 40% higher than the previous year.[6] Latin America and the Asia-Pacific (APAC) countries are touted as fertile grounds for the growth of challenger banks. They grew steadily in Latin America last year, with the year-on-year (YoY) equity funding for digital-first banks increasing by 55% in 2020.[7] They play a pivotal role in improving financial inclusion and serving the underserved as 50% of the adult population in Latin America does not have bank accounts[8] and the mobile phone adoption rate in the region is around 70%.[9] The presence of over one billion unbanked individuals in the APAC region[10] along with increasing smartphone and internet penetration make it one of the biggest markets for challenger banks.

Key challenger bank trends across Latin America and APAC countries

USD 1 billion — Challenger banks from Brazil raised over USD 1 billion in 2020 from 11 deals.

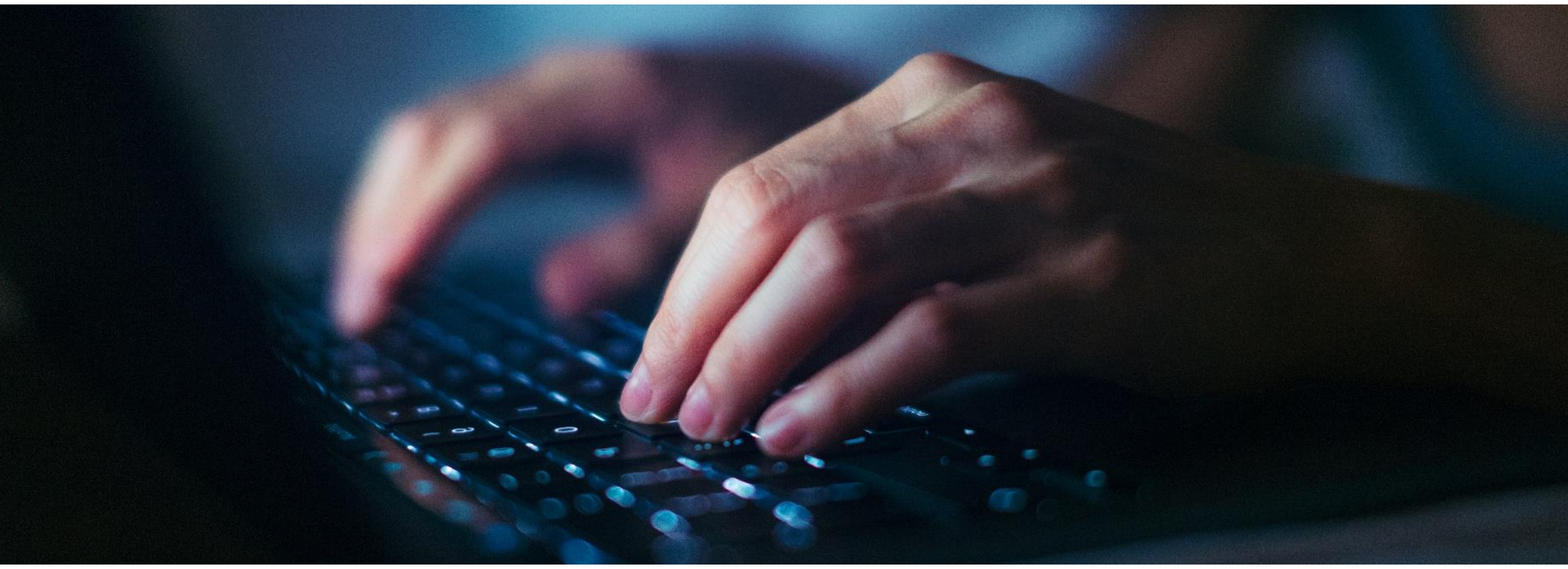
USD 110 million — Mexican challenger banks raised over USD 110 million in 2020 which is a 144% YoY increase.

35 — Challenger banks were established in the APAC region between 2016 and 2020.

63% — APAC customers are willing to switch to neobanks in 2020 according to a joint report released by a market intelligence firm and an engagement banking platform.

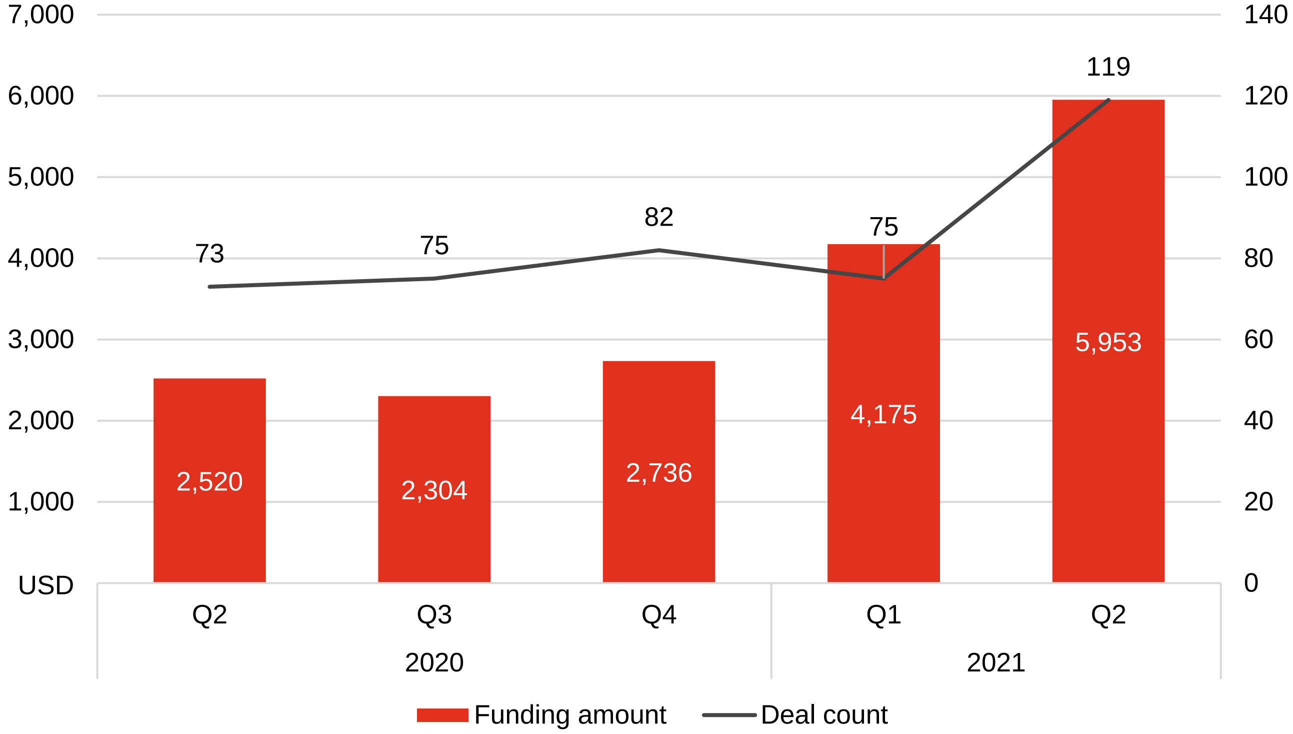
Source: CB Insights and Tech Wire Asia

The pandemic has helped investors realise the value offered by the digital-first approach of challenger banks. This reflects in the venture capital (VC) funding trends over the past year. There was a 43% quarter-on-quarter (QoQ) increase in funding and 59% increase in the number of VC-backed deals for digital-first banks from Q2 2020–Q2 2021.[11]



6 https://www.forbes.com/sites/forbesfinancecouncil/2021/07/21/challenger-bank-five-year-progress-report/?sh=2999d876da3a
7 https://www.cbinsights.com/research/latin-america-challenger-bank-funding-trends/
8 Ibid.
9 Ibid.
10 https://www.frbsf.org/banking/asia-program/pacific-exchange-blog/implications-of-asias-gender-gap-in-financial-inclusion/
11 https://www.cbinsights.com/research/report/fintech-trends-q2-2021/#:~:text=Q2'21%20was%20the%20largest,over%2Dyear%20(YoY).

Global VC-backed banking deals and funding from Q2 2020–Q2 2021 (in USD million)



Source: CB Insights

India trends

As of 2020, India had a smartphone penetration rate of 54% which is estimated to go up to 96% by 2040.[12] Even though 80% of the country's population has access to at least one bank account, the financial inclusion levels are yet to improve.[13] Though 38.2 million beneficiaries were added to the Pradhan Mantri Jan Dhan Yojana (PMJDY) in 2019–20, only 8.9 million were issued RuPay cards.[14] These data points indicate the existing gaps in India's financial services industry which could be possibly addressed by challenger banks.

India does not grant virtual banking licences to challenger banks unlike the UK. The RBI has extended the existing regulatory framework to virtual banks as well which clearly dictates that banks without physical presence in the country are not permitted to offer internet banking services[15] to Indian customers. Due to this regulatory framework, neobanks in India primarily exist as distribution channels for licensed banks or as product innovation/capability partners for traditional banks. Incumbent traditional banks are also offering digital services similar to neobanks. The concept of super apps launched by existing platform players which can provide various financial and non-financial products and services under a single roof is also gaining traction.

12 https://www.statista.com/statistics/1229799/india-smartphone-penetration-rate/

13 https://www.business-standard.com/article/finance/80-of-indians-now-have-a-bank-account-so-why-is-financial-inclusion-low-118051700150_1.html

14 https://www.business-standard.com/article/economy-policy/gap-between-pmjdy-scheme-beneficiaries-and-rupay-cards-issued-widens-121010800045_1.html

15 https://www.rbi.org.in/SCRIPTs/PublicationReportDetails.aspx?UrlPage=&ID=243

VC and PE players are also observing the market opportunities present for these challenger banks and are taking keen interest in neobank start-ups which have already raised funds in excess of USD 230 million,[16] as per a FinTech research firm. Apart from neobanking start-ups, the digital arms set up by traditional banks are also commanding high valuations. For example, the chairman of one India's biggest banks said last year that its digital banking platform is valued at over USD 40 billion.[17]

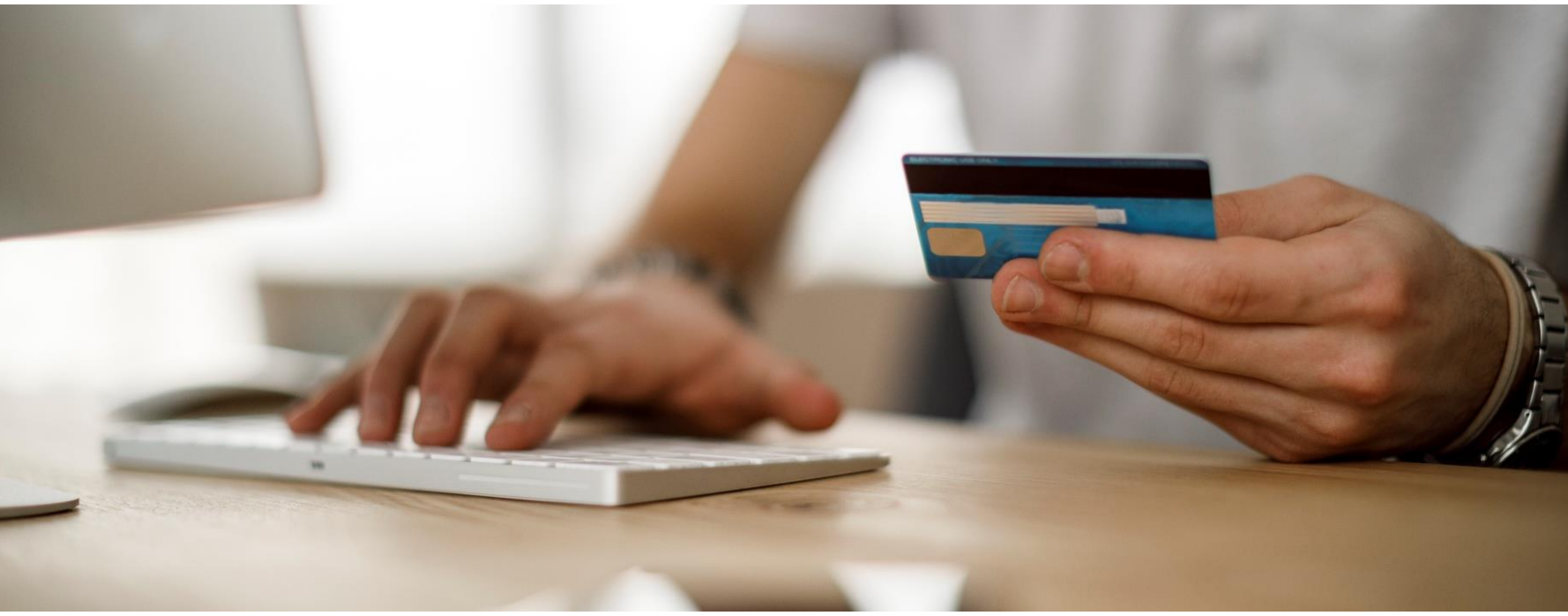
b) Types of business models

Analysis of challenger banks in India and worldwide shows that they are not restricted to a single business model. The type of business model adopted by a challenger bank is influenced by the regulations in the country of operation as well as the base business models/customers segments from which players pivot into the challenger bank model.

Types of challenger bank business models

	Neobanks/pure-play virtual banks	Incumbent digital banks	Adjacent expanders (ecosystem players)
Key features	• No physical presence • User experience focused • Transparent pricing	• Fully licensed banks with digital arms • Existing credibility	• Existing ecosystem • Anchor products
Target customers	• Niche segments (immigrants, teenagers, etc.)	• Digital friendly from existing customer pool	• Existing platform users
Products offered	Various financial and non-financial services and products		

Source: PwC analysis



[16] https://gomedici.com/research-categories/india-fintech-report-2020
[17] https://www.bloombergquint.com/business/sbi-yono-has-a-valuation-of-over-dollar40-billion-chairman-rajnish-kumar-says

Neobanks/pure-play virtual banks

Neobanks are mainly new-age start-ups that operate with a virtual banking licence or in partnership with a traditional bank. They typically operate only digitally and focus on customer experience and diversity in products offered to their target customers. Virtual banking licences are currently not issued in India as RBI regulations[18] mandate banks to have physical presence in the country to be eligible to provide internet banking services to Indian consumers. Start-up neobanks are forming strategic partnerships with existing licensed traditional banks with physical presence to address this roadblock.

Target customer segment

Most neobanks/pure-play virtual banks target specific niche customer segments. This helps them in clearly defining their customer pain points and designing products that specifically address them. For example, a virtual bank launched in the US in 2020 focuses primarily on the needs of the immigrant population[19] that does not have formal access to credit. In India, there are a number of popular neobanks which target customer segments like millennials, blue-collar workers and MSMEs.

Services offered

As these neobanks/pure-play virtual banks have specific target groups, their products are also tailor-made to address customer pain points. For example, MSMEs that usually have to undergo a complex process for paying vendors can now use a neobank platform to automate and monitor their entire payment process flow. The previously complex and opaque process has now become simple and transparent, and can be executed from anywhere. Other examples include neobanks that offer zero-fee forex transactions and multi-currency accounts which are targeted at frequent travellers, spend analytics and personal finance management offerings to millennials.

Operating model

Neobanks/pure-play virtual banks typically follow two models of operations according to the regulatory requirements of the country they operate in. In countries where virtual banking licences are available (like the UK and Singapore), they typically operate on their own. In countries like India where there are no separate neobanking licences, they enter into strategic partnerships with existing traditional banks. This enables them to serve the end customer through their digital platform while the banking regulatory requirements are adhered to by the partner bank. Such partnerships also help in superior customer acquisition as a value add due to the relationship with the partner bank.

Case study

A global challenger bank established in the UK in 2015 offering currency exchange, debit cards, virtual cards, cross-border transactions etc., is currently valued at USD 33 billion[20] (as of July 2021). It is of the most valuable FinTechs in the world. It was initially working with a challenger bank licence obtained from the European Central Bank,[21] before applying for a UK banking license[22] in January 2021. It expanded its operations into Japan in 2020 and is planning to venture into India. It is already in talks with the RBI regarding regulatory approvals and identifying local banks as potential partners.[23] This is a successful example of a pure-play virtual bank focusing on banking products through digital channels. It is also willing to enter into strategic partnerships with traditional banks in order to navigate India's regulatory frameworks.

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18 https://www.rbi.org.in/SCRIPTs/PublicationReportDetails.aspx?UrlPage=&ID=243
19 https://techcrunch.com/2021/05/10/fair/
20 https://www.cnbc.com/2021/07/15/digital-bank-revolut-valued-at-33-billion-in-new-funding-round.html
21 https://www.fstech.co.uk/fst/Revolut_Launches_Lithuanian_Bank_Operationalise_License.php
22 https://www.bloomberg.com/news/articles/2021-01-11/revolut-applies-for-u-k-banking-license-in-search-for-expansion
23 https://www.cnbc.com/2021/04/21/revolut-hires-india-ceo-ahead-of-2022-launch.html

Incumbent digital banks

Incumbent banks worldwide are noticing the value proposition offered by challenger banks and many have kickstarted their own such banks as a response. Incumbent banks have the advantage of having an existing customer base and in-depth knowledge of their financial behaviour. These can aid them in accurately identifying their target consumer segment which can be offered services by their digital arm. They have also had a head start in developing a known brand through operating for decades. The availability of existing banking licences increases the flexibility in designing the products offered. All these factors favour incumbent digital banks.

Target customer segment

Incumbent digital banks are arms of existing traditional banks with a well-developed customer base. Their target segments are usually digitally well-versed customers with an affinity towards digital banking solutions and those who value the convenience provided by such platforms.

Services offered

The services offered by such incumbent digital banks include account opening and loan approvals. Additionally, these players are also incorporating various financial and non-financial services such as partnering with popular digital platforms to transform into an ecosystem providing lifestyle solutions.

Operating model

Digital banks operate as a part of a larger incumbent bank but also partner with other vendors and platforms to develop their product range. Some incumbent digital banks also provide preferential pricing on certain products and services to drive engagement and channel adoption.

Case study

One of India's largest banks launched its integrated digital banking platform in 2017. It offers conventional banking services such as account opening and fund transfers. Additionally, it also offers various non-financial services such as e-commerce, EdTech solutions and online travel services. It even caters to the farming needs of customers by enabling the purchase of agricultural equipment and fertilisers through its partner platform. Though the platform was launched by a traditional bank, it envisions to transform itself into an omnichannel forum offering a comprehensive suite of services catering to various customer segments.

Adjacent expanders – ecosystem players

Another category of firms entering the challenger bank space are technology firms with an existing digital ecosystem platform. These firms offer financial (i.e. payments services) and/or non-financial services and products (i.e. e-commerce, personal finance management and accounting services) to their customers and can expand into providing core banking products. They have a large customer base, including both retail customers and/or businesses through their original operations, and can offer banking and financial products that are synergetic with their existing business. They can either partner with existing banking entities or apply for licences on their own.

Target customer segment

With an existing range of products and a strong customer base, these ecosystem players look to capitalise on their present channels to serve their captive customers with a wide range of value-added services.

Services offered

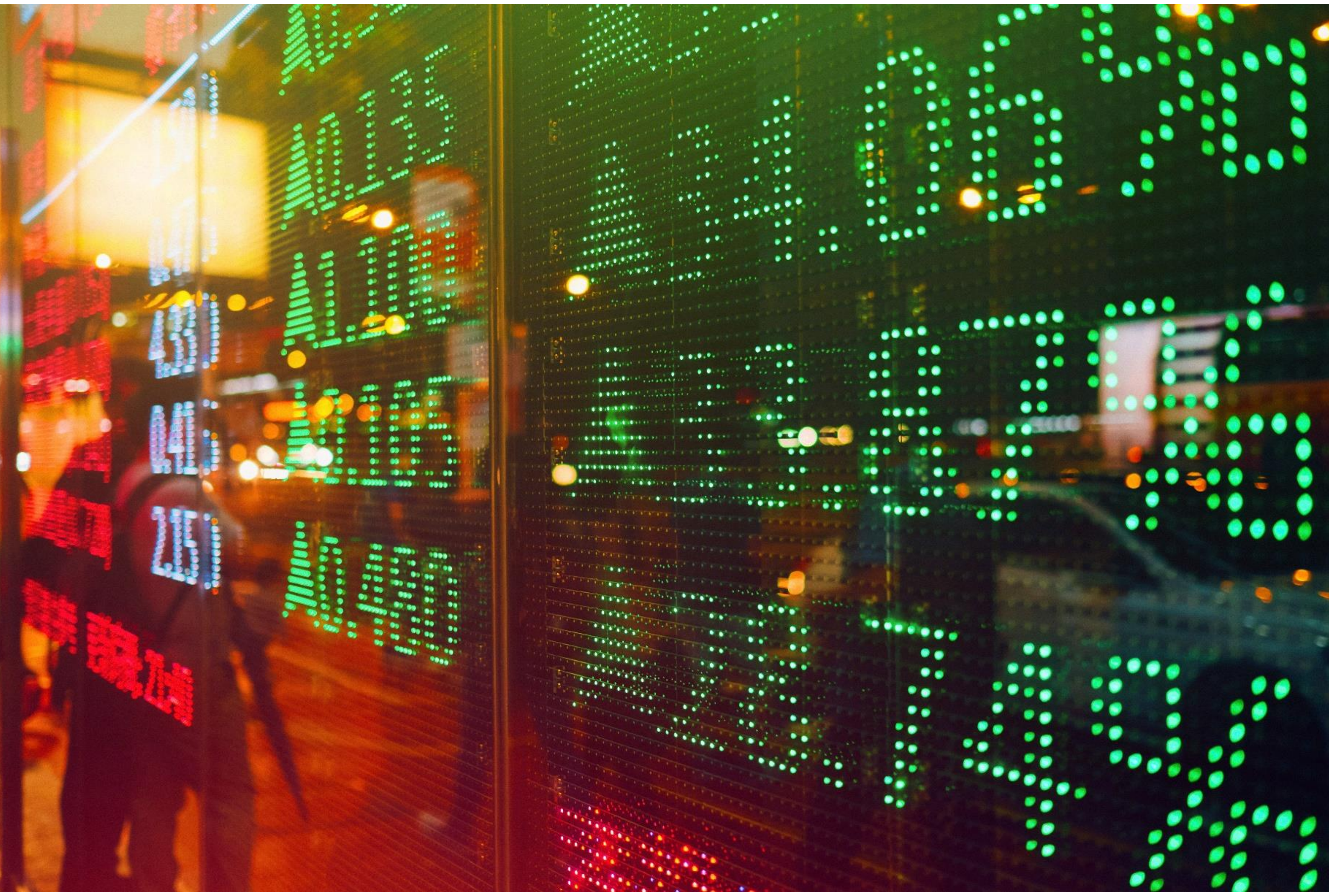
These platforms typically start off with offering an anchoring product and then expand to adjacent products. The initial product acts as a means to build a larger customer base before it can be pivoted and monetised, and related to financial services such as payments platforms, wallets or non-financial services like e-commerce. They aim to offer products/services that are synergistic with their existing range of products. For example, a platform which is currently providing e-commerce services would benefit if it could also provide small-scale credit to their customers which can then be used to purchase products.

Operating model

These are usually established entities with an existing operating model. They partner with third-party players to integrate their services into the platform. They would also look to meet regulatory requirements either through their partners or applying for licences themselves.

Case study

An Indian multinational technology company established in 2010 started off as a platform for mobile-phone bill payments. It expanded into becoming a wallet which vendors added as a payment option for their customers. In 2015, it launched e-commerce services along with a few other non-financial services. It added a variety of financial (credit and investment products) and non-financial products (personal financial management and travel) products to its platform and increased its customer base. It launched a payments bank in 2017 which offered conventional banking products like debit cards and savings accounts. The company might consider applying for converting the payments bank into a small finance bank to offer additional banking services and improve internal operating and income metrics.[24] This case study clearly depicts how a technology platform can pivot into developing an ecosystem that offers multiple financial and non-financial services and products.



24 https://www.thehindubusinessline.com/money-and-banking/paytm-payments-bank-may-soon-apply-for-conversion-to-small-finance-bank/article35397234.ece

3. Opportunities and challenges

a) Opportunities for challenger banks

The customer base of digital banks in the APAC region has grown by more than 300% over two years when compared to traditional banks.[25] The pandemic along with the rapid growth of various FinTech disruptors and challenger banks has accelerated the adoption of digital banking initiatives in traditional banks. The coming era is crucial for banks and neobanks to actively implement innovative digital propositions by investing in the right tools, partnerships and platforms to establish a successful digital brand. While going digital, banks also need to focus on various digital marketing strategies to form a connection with their target customer ecosystems so that adoption and engagement remain sustained for the various digital initiatives rolled out.

Both value drivers and value communication are subtly different from the traditional market markers in the new digital economy with metrics such as traction (daily average user growth), engagement (net present value per account, customer satisfaction score [CSAT]) and unit economics (customer acquisition cost [CAC]) being of equal importance to traditional key performance indicators (KPIs), including net interest margin, asset under management and cost of borrowing. In the growth phase, other KPIs which look at network effects, customer acquisition and activation, and monthly active users are also relevant in order to track longer-term stickiness which would culminate in higher customer lifetime value (CLTV).

Neobanks and digital incumbent banks are utilising digital technology strategies to significantly improve business unit economics and make traditionally underserved customer segments more economically viable. They have also combined such strategies with tailored and customised customer value propositions that directly appeal to the end consumer and thus allow challenger banks to capture market share from their incumbent counterparts. Using technology and partnerships to reduce the cost of acquisition and servicing, combining financial and non-financial services smartly to engage with customers, and using analytics-fuelled insights to deliver contextual and real-time value to customers are all strategies that traditional banks could look to adopt from challenger banks in order to discover further monetisation and growth opportunities. These are strategies that a number of non-financial services players have used to capitalise on their customer bases and monetise via financial services pivots.

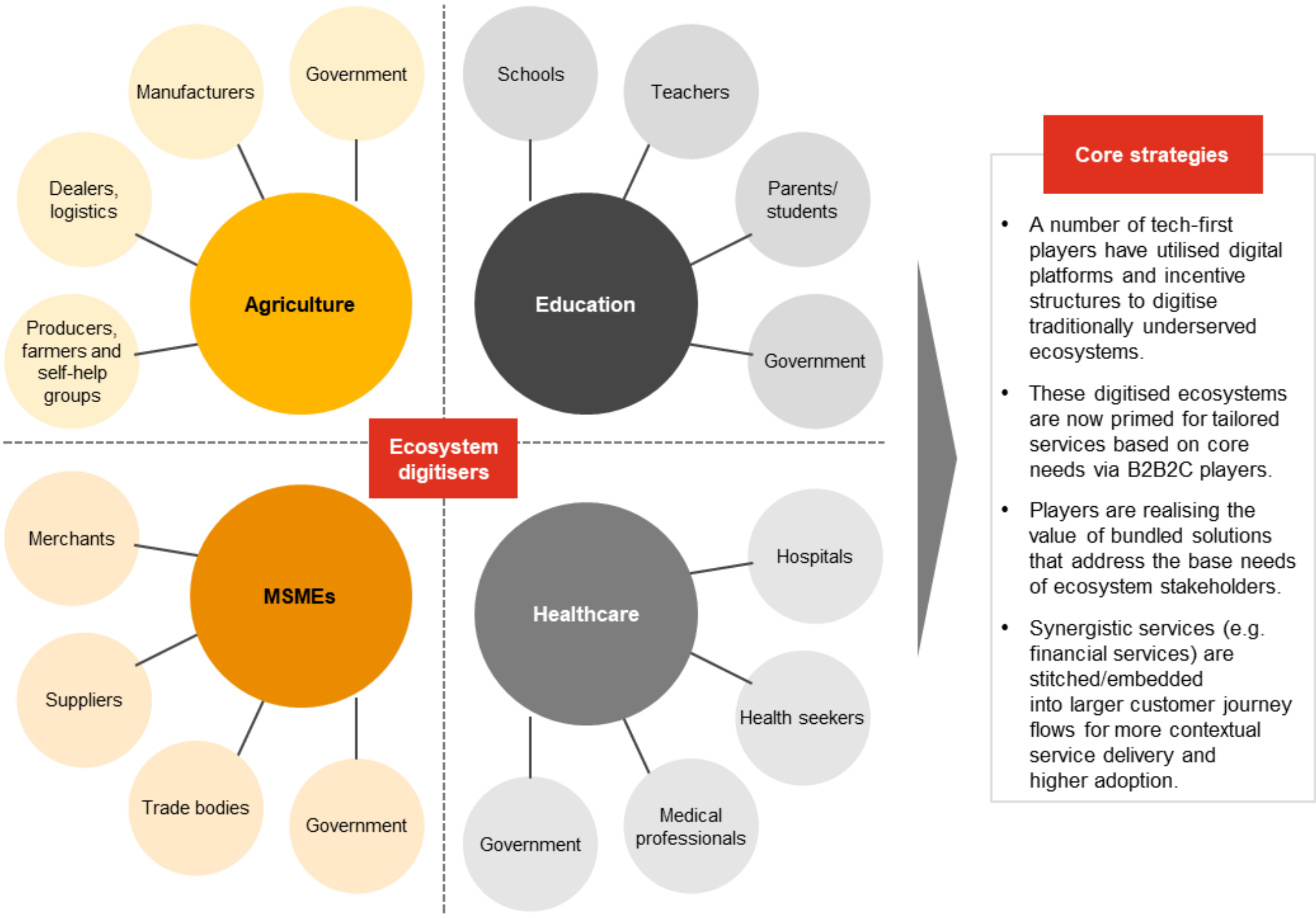
Case study

A social media application in China has grown to become an all-in-one app that provides non-financial services like messaging, video calls and blogging as well as financial services like online payments and handling official company accounts. The application enables customers to link their bank accounts and credit cards with it. Customers can purchase tickets, book appointments, pay bills and make any online purchases through the app. It also helps small businesses to create official business accounts which enable customers to purchase and pay directly with the wallet features of the application. Thus, a social media platform has integrated various features to expand adjacently into financial services.

These strategy combinations have started to give rise to a new model – ecosystem banking. The crux of the model is to utilise digital tech, smart partnerships and holistic financial and non-financial services value propositions to create products and solutions that cater to an entire ecosystem instead of individual customers. This helps in capturing more data that could be utilised to expand businesses and earn more revenue with the same amount of effort. Such strategies allow financial services players to offer their products and enable non-financial services entities to provide holistic offerings.

25 https://www.asiabiztoday.com/2021/05/25/banking-sector-must-focus-on-digital-fitness-to-tackle-challenging-environment/?utm_source=Organic&utm_medium=Website&utm_campaign=APAC-ES-2021-01-1875-Bank%20NXT%20Leadership%20Blog

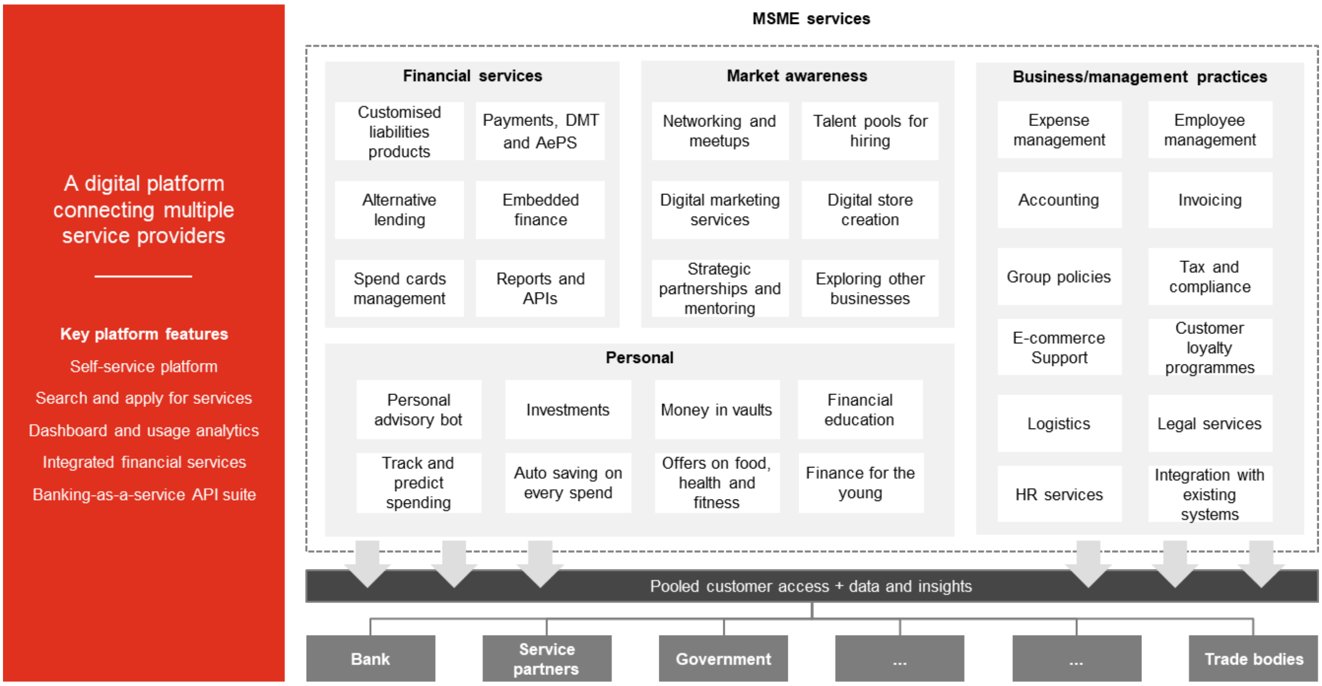
Ecosystem banking model strategies



Source: PwC analysis

As per the figure above, there are multiple stakeholders across each ecosystem for challenger banks to target. For example, the MSME ecosystem would not just involve the MSME players themselves but also their upstream and downstream networks, trade bodies, government stakeholders, etc. A digital ecosystem platform that caters holistically to the needs of MSMEs would be highly beneficial. Such a platform can offer financial services and products such as current accounts, credit facilities and payment gateway services as well as non-financial services such as access to supply networks, accounting services and digital store creation. While the financial services could be offered by a bank, the non-financial services could be offered by other FinTechs and service providers who are brought on as partners. Challenger banks could also look to embed their services within non-financial offerings to further improve the chances of adoption.

Ecosystem banking platform for MSMEs



Source: PwC analysis

The platform depicted in the figure above could pool the collective resources of all partners to acquire and bring together customers. The platform partners could also reap the benefits of providing a holistic set of services to MSMEs and ensuring sustained engagement. Furthermore, the platform would also provide access to rich consumption data (based on consent) that could be utilised by all the players for insight creation and service customisation. The same data would also be relevant to trade bodies, governments and other stakeholders who could utilise such insights for developing strategic policies. The platforms could also be used to reach MSMEs for tactical operations (for instance, benefits transfer to MSMEs, tax collection, etc.). The platform would thus be relevant to the ecosystem and organically grow and sustain value. Challenger banks and incumbents could look to build such collaborative platforms to serve ecosystems and also aid in penetration of inclusive financial services.

As challenger banks and incumbents look to develop such ecosystem platform strategies, they would need to focus on the following core capabilities:

A	Setting up strong digital platform technologies to facilitate the end-state vision and deliver a smooth and seamless customer experience
B	Setting up processes and technologies for quick integration with partners and vendors (API strategies)
C	Developing capability partnerships for relevant service categories on the platform and distribution partnerships to drive customer acquisition, growth and reach
D	Developing integrated digital marketing strategies to drive customer adoption and engagement
E	Developing data strategies to ensure consent-driven data collection and advanced analytics driven insight generation and insight delivery to provide products and solutions relevant to the customers in the ecosystem

b) Challenges

The success and scalability of challenger banks in a culturally and socioeconomically diverse country like India requires nuanced and focused strategic approach. The key to success for challengers banks lies in targeting the specific needs and considerations of the desired market segments and taking into account the critical considerations around the adoption of the right technology, culture and business strategies.

Some of the core business challenges that challenger banks face are analysed below:

1 Legacy technologies (applicable particularly to incumbent digital banks)

Technology is one of the main challenges faced by incumbent digital banks which use the capital, channels and infrastructure of their parent banks. Usually, incumbent banks are built on monolithic mainframe legacy technologies. However, providing a seamless experience to end customers would require such banks to use a plug-and-play design stack on underlying API integrations and microservices. This is particularly important given the impetus of digital processes, integrated customer views across products and internal business streams as well as quick go-to-market partnership plans that financial services players are now adopting as hygiene strategies.

2 Establishing brand and trust (particularly applicable to neobanks)

Communicating reliably and building trust are two major aspects of consideration for neobanks when establishing strong financial services relationships with end customers. Building brand trust ultimately translates into business and monetisation. Budding neobanks are at a disadvantage in this prospect, especially when competing with established legacy incumbents. Neobanks operating in India would be required to provide superior value-added services and communication to end customers along with ecosystem awareness to establish trust. Hence, some models like freemium subscriptions/memberships are prevalent in neobanking where the customer experiences the product before being charged for the value-added service.

3 Maintaining a balance between scale, growth and profitability (applicable to incumbent digital banks, neobanks and adjacent expanders)

Challenger banks are still a recent phenomenon in India and the gains are usually wafer thin, leading to low profitability and solvency risks. While most start-up neobanks are still in the growth phase, profitability/business viability is dependent on defining the target group, product/service, distribution channels, partner/vendor contracts, etc. Given the range of options available and resulting price sensitivity, players are constantly having to drive high-volume adoption in order to meet revenue requirements to cover the costs incurred, particularly related to technology and marketing. Challenger banks would need to identify businesses and monetisation strategies to maximise customer value while balancing strategies around raising capital and cash burn to manage business viability.

Case study

An Indian mobile-first neobank start-up which aimed to provide personalised offerings like insurance, credit and pay with ease to gig economy workers was shut down in Q1 FY21. The start-up targeted blue-collar workers who earned less than INR 30,000 per month. It faced difficulties to define a viable business model and product market fit for its target segment. The pandemic also affected its plan of engaging and acquiring potential customers.[26] These factors hindered the start-up's efforts to raise another round of funds and continue operations.

[26] https://entrackr.com/2021/07/exclusive-matrix-backed-neo-banking-app-yelo-shuts-down/

4. Recommendations

A consumer's financial requirements and needs keep changing. A challenger bank should not only be able to meet a customer's current needs but also predict and provide for future requirements. Given the sustained growth of challenger banks in the past few years, it will be useful to look at some of the business strategies that could aid in their expansion:

Continued focus on niche segments

Building solutions focused on specific user bases largely ignored by traditional banks have helped challenger banks grow significantly. Focusing on new segments will further aid in the expansion of this sector. Challenger banks could also look to maximise the lifetime value of their customers through offering a range of basic as well as value-added services to customers.

Ecosystem strategy

Aggregating multiple services of different use cases in a single platform would further ease the customer's pain point along with ensuring higher engagement for the bank. Collaborating with different service providers and aggregating their services will be a good ecosystem strategy to consider. Challenger banks would need to ensure that the right capabilities such as API technologies and digital marketing are adopted to reap benefits from the ecosystem players.

Financial education

Some challenger banks focus only on serving bottom-of-the-pyramid or new-to-banking customers. It is imperative to impart financial literacy to such customers through bite-sized learning. This will proactively help them save money as well as invest it for the future. Such strategies have already reaped benefits for a number of FinTechs that have used financial literacy services as stepping stones for building brand trust building and acquiring customers.

Path to profitability

Challenger banks are yet to be consistently profitable despite continued user growth. They should relook at funding deployment and optimising costs through technology and partnerships. For example, a reduced cost of acquisition through partnerships with synergistic players could also help acquire high-quality customers. Balancing reach and cost will be the priority for challenger banks in India where 'phygital' models are essential to succeed. There is no single, proven path to profitability for a challenger bank but studying successful establishments reveals the importance of the right product-release sequence. Monitoring and managing revenues in parallel to identifying areas where the bottom line can be improved would be key to the long-term success of challenger banks.

The challenger bank landscape has already seen significant traction, consolidation and growth with incumbents, start-ups and non-financial services adjacent expanders involving themselves. While the strategies and models adopted have evolved over time, it is clear that an approach that embeds itself within an ecosystem lens – both in terms of customer ecosystem penetration as well as partner ecosystem building – is already providing value to successful players. Challenger banks will have to continue focusing on customer experience and digital technologies as two cornerstone strategies. However, ecosystem approaches could result in further sustained profitability and business viability.

About ASSOCHAM

Evolution of Value Creator

ASSOCHAM initiated its endeavour of value creation for Indian industry in 1920. Having in its fold more than 250 Chambers and Trade Associations, and serving more than 4,50,000 members from all over India. It has witnessed upswings as well as upheavals of Indian Economy, and contributed significantly by playing a catalytic role in shaping up the Trade, Commerce and Industrial environment of the country.

Today, ASSOCHAM has emerged as the fountainhead of Knowledge for Indian industry, which is all set to redefine the dynamics of growth and development in the technology driven cyber age of 'Knowledge Based Economy'. ASSOCHAM is seen as a forceful, proactive, forward looking institution equipping itself to meet the aspirations of corporate India in the new world of business. ASSOCHAM is working towards creating a conducive environment of India business to compete globally.

ASSOCHAM derives its strength from its Promoter Chambers and other Industry/ Regional Chambers/Associations spread all over the country.

It was established in 1920 by promoter Chambers, representing all regions of India.

Vision

Empower Indian enterprise by inculcating knowledge that will be the catalyst of growth in the barrierless technology driven global market and help them upscale, align and emerge as formidable player in respective business segments.

Mission

As a representative organ of Corporate India, ASSOCHAM articulates the genuine, legitimate needs and interests of its members. Its mission is to impact the policy and legislative environment so as to foster balanced economic, industrial and social development. We believe education, IT, BT, Health, Corporate Social responsibility and environment to be the critical success factors.

Members – Our Strength

ASSOCHAM represents the interests of over 4,50,000 direct and indirect members across the country. Through its heterogeneous membership, ASSOCHAM combines the entrepreneurial spirit and business acumen of owners with management skills and expertise of professionals to set itself apart as a Chamber with a difference.

Currently, ASSOCHAM has over 100 National Councils covering the entire gamut of economic activities in India. It has been especially acknowledged as a significant voice of Indian industry in the field of Corporate Social Responsibility, Environment & Safety, HR & Labour Affairs, Corporate Governance, Information Technology, Biotechnology, Telecom, Banking & Finance, Company Law, Corporate Finance, Economic and International Affairs, Mergers & Acquisitions, Tourism, Civil Aviation, Infrastructure, Energy & Power, Education, Legal Reforms, Real Estate and Rural Development, Competency Building & Skill Development to mention a few.

Insight into ‘New Business Models’

ASSOCHAM has been a significant contributory factor in the emergence of new-age Indian Corporates, characterized by a new mindset and global ambition for dominating the international business. The Chamber has addressed itself to the key areas like India as Investment Destination, Achieving International Competitiveness, Promoting International Trade, Corporate Strategies for Enhancing Stakeholders Value, Government Policies in sustaining India’s Development, Infrastructure Development for enhancing India’s Competitiveness, Building Indian MNCs, Role of Financial Sector the Catalyst for India’s Transformation. ASSOCHAM derives its strengths from the following Promoter Chambers: Bombay Chamber of Commerce & Industry, Mumbai; Cochin Chambers of Commerce & Industry, Cochin: Indian Merchant’s Chamber, Mumbai; The Madras Chamber of Commerce and Industry, Chennai; PHD Chamber of Commerce and Industry, New Delhi and has over 4,50,000 Direct / Indirect members. Together, we can make a significant difference to the burden that our nation carries and bring in a bright, new tomorrow for our nation.

ASSOCHAM members represent the following sectors:

- Trade (National and International)
- Industry (Domestic and International)
- Professionals (e.g. CAs, lawyers, consultants)
- Trade and Industry Associations and other Chambers of Commerce

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About PwC

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GG/September 2021 – M&C 14942