

How to win against neobanks

Strategies for beating fintechs
at their own game

MANTL

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INTRODUCTION

The growing demand for digital banking

Neobanks have been making headlines in recent years, thanks in part to massive fundraising rounds and high-profile marketing efforts. But retail banking customers—and younger consumers in particular—have, in fact, flocked to neobanks (also known as digital banks or challenger banks) like Chime, Current, and Varo, charmed by these new contenders' digital-first approach to banking. As a result, **neobanks' market size is growing and is expected to reach 722.6 billion by 2028.**¹

Given the success of the neobank model, community financial institutions (FIs) interested in developing digital capabilities can study the customer experience (CX) practices of challenger banks, and apply lessons learned to their own digital strategy.

This white paper will reveal:

- What a neobank is, and how the business model works
- Risks inherent to a digital-only strategy
- Where and how neobanks have found success
- Digital opportunities for community institutions

Community FIs and neobanks may not always be each other's direct competition. But it's clear that neobanks have uncovered a real and growing demand for great online experiences. **With the right strategy, community FIs can capitalize on this demand, while also providing more stability, local support, and superior customer service outside the digital channel.**



¹Grand View Research, *Neobanking Market Size, Share & Trends Analysis Report by Account Type*, January 2021.

THE DRAW TOWARDS DIGITAL SERVICES

Getting to know neobanks (and why customers choose them)

Neobanks belong to a growing number of FIs that interact with consumers exclusively through digital channels. The largest of the neobanks include:²



13.1 million customers
\$25B valuation



4.0 million customers
\$2.2B valuation



3.0 million customers
\$2.3B valuation



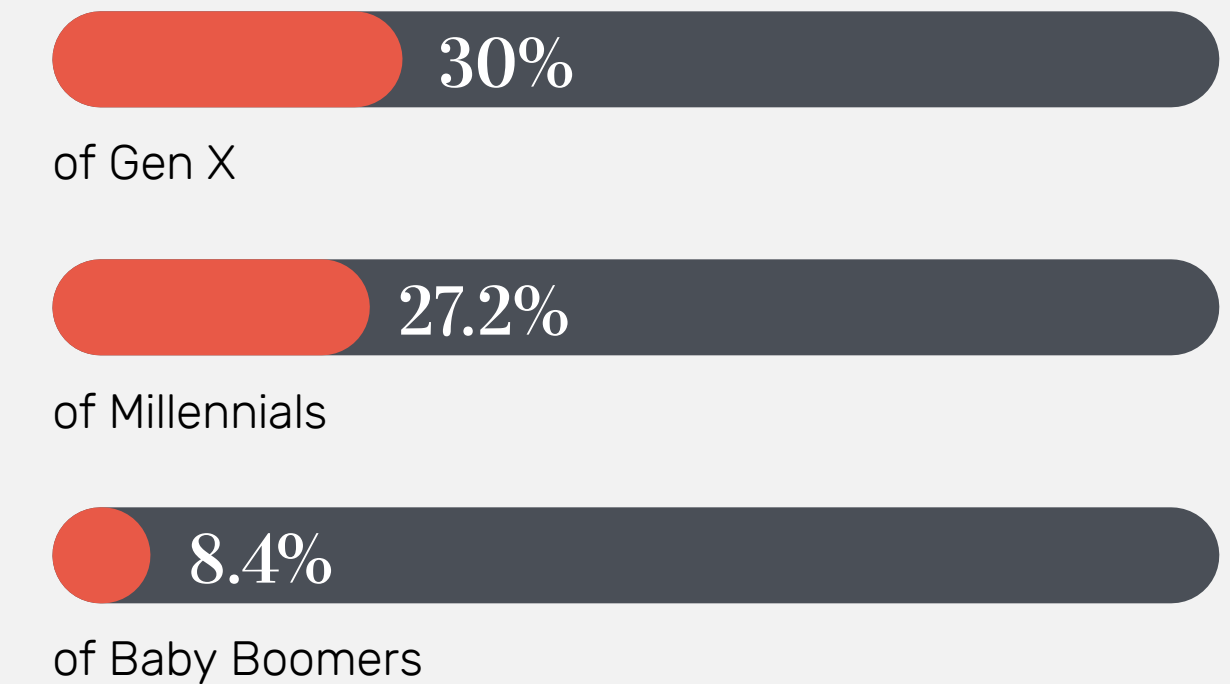
2.7 million customers
\$2.5B valuation

Neobanks' digital-only approach comes with a few advantages. First, neobanks don't operate branches, which eliminates a significant operating expense incurred by most other banks and credit unions. In theory, neobanks pass this efficiency on to customers in the form of better interest rates.

Second, neobanks' narrow focus on digital means that they offer ways for customers to conduct any task—depositing checks, paying bills, opening new accounts, or even receiving one-on-one support—digitally. This appeals to a younger, digital-loving demographic of consumers who are looking for a convenient banking experience and don't mind transacting entirely through their FI's website or mobile app.³

Over time, the model appears to be gaining traction. According to the [2021 Banking Impact Report](#), **consumers indicate a willingness to consider digital-only banking, with younger consumers appearing particularly enthusiastic about it.**

Who are neobanks' customers?



Who plans to open an account at a digital-only bank in the next 12 months?



Source: [2021 Banking Impact Report](#)

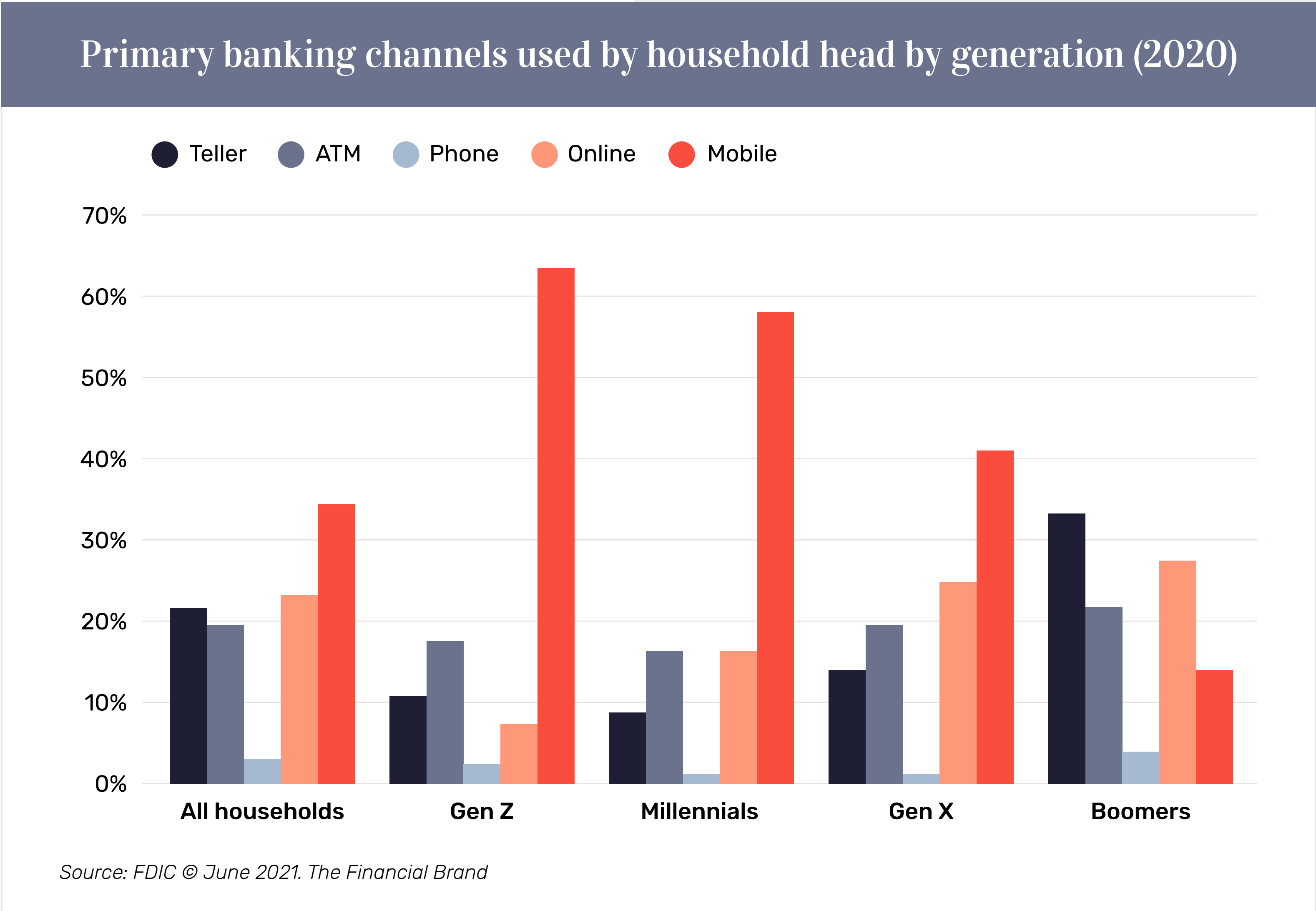
² Insider Intelligence, *What Neobanks Are, How They Work and the Top Neobanks in the US & World in 2021*. August 4, 2021.

³ The Financial Brand, *Obsessing over Younger People Kills Financial Marketers' Opportunities*, June 22, 2021.

Among the reasons Millennials listed for their interest in neobanks were lower fees and ease of digital transfers.⁴ The digital-only approach of neobanks is clearly connecting with some consumers, and even if community banks and credit unions don't want to directly emulate neobanks, those who don't offer a strong digital experience risk losing existing digital-loving customers—and also failing to attract new ones.

Today, neobanks control a mere fraction of the retail banking market. However, estimates place the sector's annual growth rate at 47.1 percent.⁵ Furthermore, many neobanks are even specializing along "affinity" lines by leveraging a deep, data-driven understanding of their customer base, suggesting that **deeper banking relationships and greater share-of-wallet is the prize that neobanks are after in the long term.**⁶

If so, **community FIs should be ready to compete.** [Hyper-personalization delivered via digital channels](#) is a growth opportunity for community FIs—but not if neobanks get there first.



⁴ Finder, *Digital Only Banking Adoption 2021*, October 5, 2021.

⁵ Business Wire, *Global Neobanking Market (2020 to 2026) - by Account Type, Application and Region*, April 20, 2021.

⁶ Forbes, *The Rise Of Community Fintechs And How They're Redefining Community Banking*, September 13, 2021.

Where neobanks still fall short of today's consumer expectations

“Neobanks continue to score massive valuations but consumers and businesses are not completely sold on the neobank promise. In fact, they are just as likely to open an account at a community bank or credit union in the next 12 months. The biggest threat to traditional banks is not a neobank but the opportunity cost of not keeping pace with increased demands for digital banking.

— Nathaniel Harley
CEO, MANTL

There's a significant disconnect between the valuations of neobanks and their actual income generated per customer.⁷ Though several of them are valued in the billions, short-term profitability remains elusive.⁸ Furthermore, neobanks—as new entrants to the banking space—may be less stable than traditional FIs. Most of them don't have a bank charter, and instead partner with an established bank to provide the backend for their products.

And while neobanks' signature feature—their lack of brick-and-mortar branches—appeals to some consumers, it may also be their greatest drawback. **Many consumers trust in-person transactions more than they trust mobile**, according to a February 2021 study.⁹

Which type of transaction do you trust more?

	In-person	Mobile
Gen Z	34%	52%
Millennials	40%	51%
Gen X	48%	43%
Boomers	64%	27%

Source: [2021 Banking Impact Report](#)

⁷ Finextra, *Neobanks Should Find Their Niche to Improve Their Profitability*, December 30, 2020.

⁸ TechCrunch, *Neobanks' Moves Toward Profitability Could Be the Path to Public Markets*, August 4, 2021.

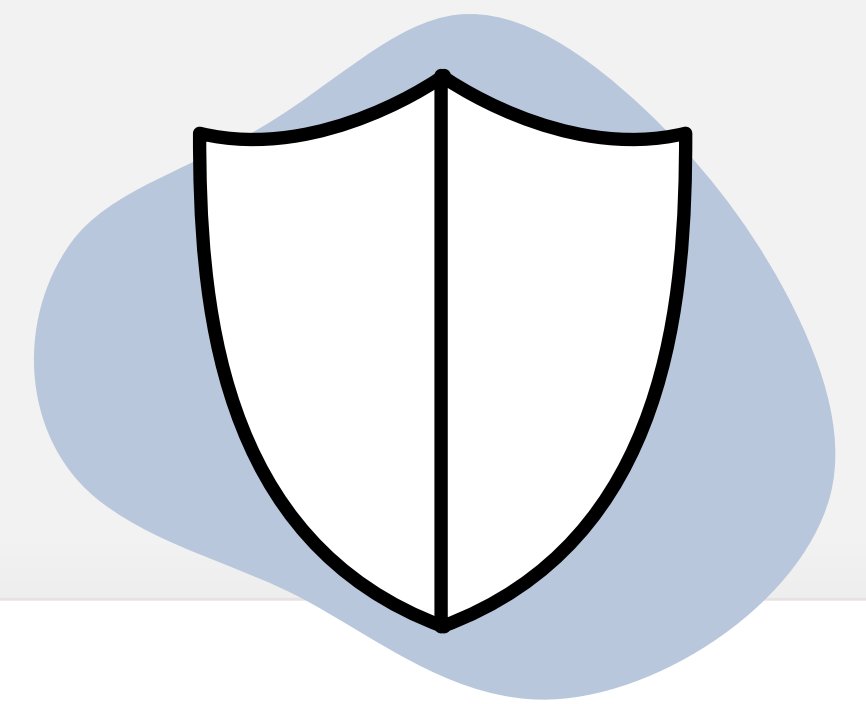
⁹ Oxygen, *Oxygen Survey: Pandemic Accelerated the Adoption of Mobile Banking Apps and Contactless Payments*, February 23, 2021.

Distrust of the mobile channel seems to extend to neobanks as a category. **According to MANTL's [2021 Banking Impact Report](#), only 7 percent of consumers trust digital-only banks over traditional banks.**

This trust gap may be due to the controversies swirling around some neobanks in recent months. One example is Chime, which has seen hundreds of complaints filed with the Consumer Financial Protection Bureau after some customers reportedly had their accounts closed without notice.¹⁰ Chime has said that many of these account closures were linked to fraud or to incorrectly distributed stimulus payments—but also admitted that several of the closures were made in error.

In fact, fraud has been a growing concern for neobanks in general. The *2021 Banking Impact Report* found that in the past 12 months, 61 percent of community bank and credit union executives observed an increase in fraudulent activity with accounts held at neobanks. According to a 2019 report by the National Consumer Law Center, the sign-up process neobanks use may be the reason they have become targets for fraudsters.¹¹ Banks like Chime and Varo don't check applicants' credit and don't disqualify people who have been rejected by banks before. As a result, bad actors have been able to open multiple accounts under false identities to collect extra government benefits or receive money from hacked accounts.

For fraud-conscious consumers, the sleek digital experience offered by neobanks may not outweigh the risk of using a less-established banking model.



→ Community FIs can provide the best of both worlds: superb digital experiences with all the support and stability of an incumbent institution.

¹⁰ ProPublica, *A Banking App Has Been Suddenly Closing Accounts, Sometimes Not Returning Customers' Money*, July 6, 2021.

¹¹ National Consumer Law Center, *Fintech and Consumer Protection: A Snapshot*, March 2019.

Important lessons learned from neobanks— and how to implement them

Neobanks, by design, lean on strong digital capabilities—and little else. At minimum, their success is proof that when it comes to digital experiences, quality can be a differentiator.

Community banks and credit unions shouldn't think of great digital experiences as a nice-to-have, but rather as another necessity—like rates, product development, or branch network reach—in the modern competitive landscape.

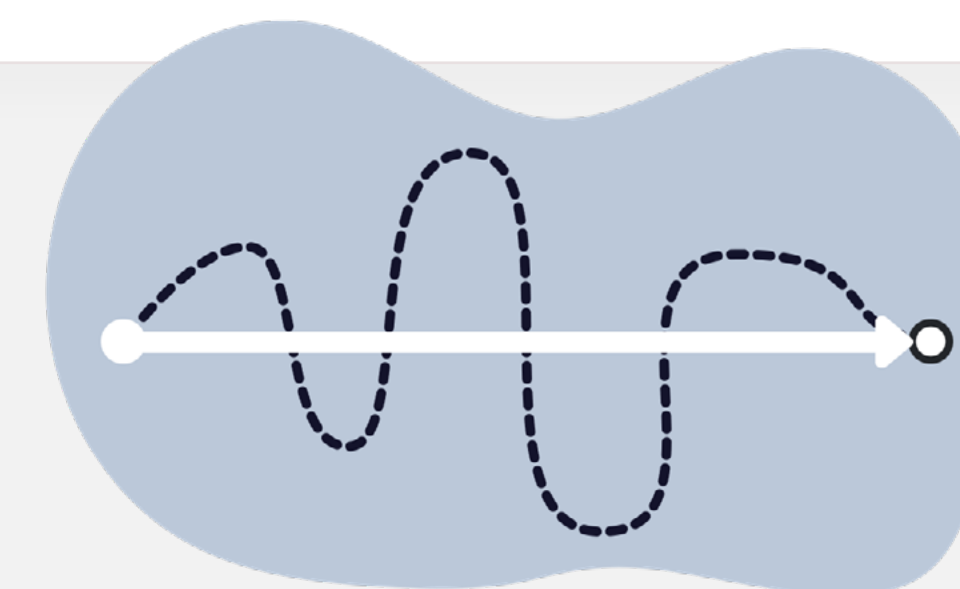
According to the [2021 Banking Impact Report](#), 99 percent of community banks and credit unions have not fully embraced digital banking. **That means it's time to learn from neobanks about what makes a good digital experience.** Here's what community FIs can take away from the neobank approach.

1. Invest in quality customer experience (CX)

The success of neobanks shows that customer experience moves the needle. **Community FIs need to ensure that their digital experiences are streamlined and convenient, particularly during the onboarding process.** Using time-to-open as a rough proxy for measuring the quality of the account opening experience, a good rule of thumb is that customers should be able to open an account online or via mobile in three minutes or less.

This means that FIs should only ask for the information they truly need during onboarding—like the minimum address history to run a credit check—instead of asking customers to provide a copy of their ID or other documents.

→ To design a great onboarding experience, your FI should declutter the process and put fewer obstacles in applicants' paths.



2. Get to know customers through their data

In providing a high-quality digital experience, neobanks have become skilled at personalization—offering customers the products and services they need according to their life stage, financial status, and interests. MoneyLion, for instance, is a neobank designed as a private FI for the \$50,000 household. Most of its customers have less than \$2,000 in savings and are first-time investors. MoneyLion’s products and services cater to the needs of this specific demographic.

Similarly, community banks and credit unions can use data to provide tailored experiences to in-market consumers across every channel. Your FI should look to use data to build products with specific customers in mind, or even consider [launching a greenfield bank](#) designed for a specific audience.

3. Commit to omnichannel

High-quality digital and in-person experiences are, in fact, compatible. With an omnichannel solution, customers can open accounts online or in-person with equal ease—or even start an application on one channel and finish it on another.

By fully integrating digital into their institution’s DNA, community FIs allow customers to engage with them regardless of the platform.

This is the real opportunity: provide a winning digital front-end to tap into the same demand as neobanks, and then offer reliable, high-touch support to retain and deepen those relationships.



CONCLUSION

With the right tools, community banks and credit unions can win digitally

Community FIs already offer many benefits that neobanks don't. And while it's possible for community FIs to encroach on neobanks' turf through targeted investments in digital, it doesn't work in reverse. Neobanks can't copy what makes community banks and credit unions unique.

However, the demand for digital is real—and it's not going anywhere. Now is the time for community FIs to learn from neobanks' success so they can adapt, compete, and thrive in a rapidly changing landscape.



About MANTL

MANTL is a banking technology firm offering the leading account opening software. Our platform empowers regional and community banks and credit unions to grow up to 78 percent faster. These institutions play a critical role in our economy and we're passionate about preserving that. Founded in 2016, MANTL has raised billions in core deposits to date. MANTL is a privately held company headquartered in New York with the backing of prominent venture capital investors.

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