Sink or swim: What the profitability of neobanks means for incumbents

The way we are saving, accessing and investing our money has never been more diverse than in the modern day. Jonathan Hughes, CEO of Pollinate Horizons, explores the rise in banking innovation and what this means for the original bricks-and-mortar banking world.

Temps de lecture : minute

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25 February 2021

Traditional banks face a new dawn in which they're required to prove themselves as viable competition to more agile and innovative newcomers to the industry.

Until recently, challenger banks such as Monzo and Revolut have faced criticism from more established players, and even the *Bank of England*. Despite enhanced customer service, faster decision-making, and new and innovative offerings, their failure to deliver a profit meant they were never taken particularly seriously by incumbent banks.

Toward the end of last year, however, *Starling* became the first challenger bank in the UK to turn a profit while, more recently, a $400M funding round made the Brazilian Nubank the world's most valuable banking startup.

With this new breed of digital-only 'neobanks' finally proving its worth and profitability, the traditional banks will need to step up and defend their position in the market.

Necessary innovation

Digitalisation matters, of course. Speed, convenience and security are priorities for consumers today, so it's essential that – if they are to survive and thrive in today's marketplace – banks digitise their services to meet these evolving needs. At the same time, it's important they also innovate and modernise their existing offerings.

Indeed, a reliance on outdated legacy technologies and long-established processes can actually be a major hindrance to the progress of traditional banks, given the amount of time and investment required to make any effective changes.

The global pandemic is a perfect illustration of a set of circumstances in which such innovation is needed. Adhering to various lockdown restrictions, many people have been unwilling – or unable – to visit their local stores and have turned to online retail instead. Global daily ecommerce sales rose by 66% when lockdown measures were first introduced. Of those that did venture out during that first lockdown, concerns that cash may spread the virus meant 90% of all face-to-face transactions carried were contactless.

Mutual benefits

Businesses have suffered as a result of the Coronavirus too, of course, and small businesses in particular. Banks and the services they provide are the lifeblood of these businesses in times of economic crisis or otherwise. But it's in situations like this that, by working closely with fintechs, high street banks can develop their digital offerings in support of all of their customers – both consumer and businesses.

NatWest, for example, worked with Pollinate and software developers Endava to create Tyl by NatWest, a merchant payment which enables small businesses to accept Chip & PIN, contactless, and telephone payments over the phone, using a mobile terminal or in store. They also developed Payit by NatWest, which allows customers to make instant online payments to retailers without the use of a debit or credit card.

As well as enabling consumers and businesses to continue transacting – importantly, in a safe manner – digital solutions such as these represent a number of benefits for the banks themselves. Diversifying their product offerings, for example, can open up new revenue streams, while analysing the data gathered from working with customers in a digital, rather than physical spaces, can be used to personalise and inform future products and services.

Perfect timing

Banks have historically played a fundamental role in a country's economy, supporting consumers and businesses with essential expertise and capital. But retail banks have recently found themselves facing stiff competition from agile, digital-first neobanks – a degree of competition that has been further increased by recent announcements from the likes of Starling and Nubank.

The banking industry has been undergoing a digital transformation for more than a decade: beginning by managing the fallout of the global financial crisis of 2008, and accelerated by the introduction of Open Banking and its accompanying APIs in 2016. Today, the impact of COVID-19 has lent further urgency to the need for digitalisation. It could be argued that the timing is perfect.

As neobanks become increasingly more competitive, it's never been more important for established banks to collaborate with fintechs, expand their digital offerings, and overhaul the outdated, legacy technology holding them back from true innovation.

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