The rise of neobanks

A study into how banks can compete against digital-only brands

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The banking industry has begun to see digital-only "neobank" models disrupting traditional approaches.

Digital-only banks such as Chime, Ally, Varo, and PayPal are rapidly increasing their number of checking and savings customers. This gives them a solid foothold in a coveted area of financial services — the primary financial relationship (PFR). Industry data suggests the trend will continue, signaling a possible broader shift in the banking industry. (The number of digital-only account holders is forecasted to nearly double by 2025, to reach nearly 40 million people.)

As neobanks continue their rise, it's growing easier and easier for customers to switch up their banking relationships and embrace a variety of digital-only choices in the market. But traditional banks can build out a digital-first strategy designed to help keep their customers. They just need to understand the pain points and "triggers" that motivate customers to open digital-only accounts.

A relationship crisis is looming

Traditional banks need to first understand why more and more customers are choosing to join digital-only challengers, if they are to avoid a relationship crisis with them.

Amdocs — through its projekt202 consulting arm — recently conducted qualitative research into why banking customers are gravitating toward digital-only banking models and adopting new digital-first services.

"Many of the reasons customers leave and go to these digital banks are things that banks can fix," says a customer experience design leader at projekt202, of the research findings. "Some of the triggers for attrition are pretty basic and simple things, but as organizations get larger and more complex, sometimes they lose sight of customers and their overall experience."

"In five or six years, neobank customers are going to become 25% of the market. And then, once it's 25%, neobanking is going to be very quickly ubiquitous."

KATIE PAGENKOPF Practice Lead, Financial Services, Amdocs

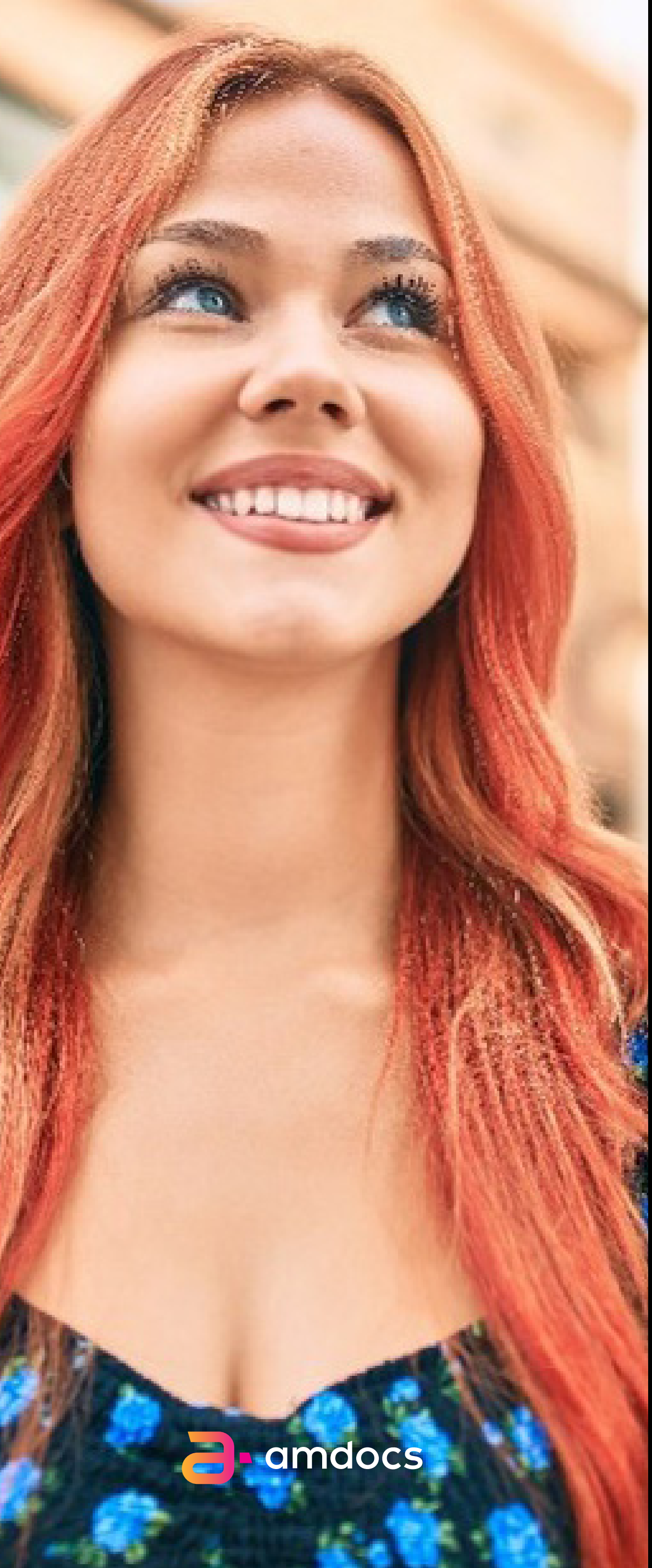
Common attrition triggers include:

1. **Customer service issues:** Consistently negative customer service experiences remain the leading cause for switching primary banks.

2. **Fees:** Customers can get fed up with unforgiving fee policies, hidden fees, total fee amounts and fees they unknowingly accrue.

3. **Life events:** Moving on from a life event or out of a market can trigger a change in a banking relationship.

4. **Rates and returns:** Customers may feel motivated to switch banks when reassessing their financial priorities, particularly savings account rates.



Captivate the next generation of banking customers

Digital-only banks seem to understand how to attract new customers from those common attribution triggers, and are going after tech-savvy, cost-conscious, time-poor customers who want a personalized experience.

"If you look at Chime's benefits, they don't really say, 'Hey, we're digital-only,'" says a specialist in financial experience design. "They say, 'Hey, we fixed all of these problems that you have with your current bank. We don't have monthly fees, we have fee-free overdraft, we have high-yield savings accounts, and so on."

Research participants shared examples of why digital-only banking won them over. One research participant told us he'd been doing some research late at night, and he basically faced the decision of opening an account right then through his mobile app with a digital-only bank, or waiting until tomorrow to drive into town to visit a traditional bank branch and potentially be told he didn't have the right documents. In that moment, joining the digital-only bank was a very easy choice for him to make.

Benefits are winning digital challengers new customers. Many Amdocs' research participants cited a number of common conversion drivers as reasons they joined a digital-only bank.

Why do digital-only options win customers?

1. **Proven customer service:**
Digital-only banks are proving they deliver excellent service and online reviews confirm it.

2. **Anti-fee practices:**
Digital-only banks welcome new customers with low- or no-fee offerings.

3. **Attractive experience:**
Customers seek out an appealing experience, and judge bank interfaces via app stores, YouTube, and other sites before joining.

4. **Digital convenience:**
Digital-only banks are easier to join and less complex to navigate than traditional banks.

5. **Product advantages:**
From higher-yield savings to real-time money movement, digital banks offer products traditional banks do not.

6. **Established relationship:**
Some customers established relationships with digital banks years ago, leading to pre-existing l evels of trust with them.

A combination of the above drivers often influenced customers to convert to a digital bank. For example, in seeking out a bank with low fees and an attractive experience, a customer may come across the fact that they can open a digital-only bank account quickly and easily online — adding to the convenience factor.

Mastering customer retention

After making the choice to open a digital-only account, customers find that digital banks deliver on their promises.

Customers come across advertisements for digital banks on social media, and what stands out to them most is the messaging around 'no fees' and current interest rates. After joining digital banks, customers experience very quickly that they aren't getting hit with fees. And as soon as they put money in a savings account, they instantly see the interest-rate impact.

Digital-only banks are smart to lean on the experience advantages customers will see quickly. Traditional banks must take note and work to stay ahead of that approach.

Key reasons customers stay with digital-only banks:

1. **Delivering on promises:** Digital-only banks consistently achieve claims of great service, no fees, and convenience and ease.

2. **Cost conscious:** Digital banks offer credit-building products, superior budgeting features, and additional fee relief that make customers feel the banks care personally about their financial wellbeing.

3. **'Test to adopt' ability:** Customers can grow their comfort level with digital banks by starting with small amounts and testing out tools and features.

4. **More focused approach:** Customers enjoyed fewer irrelevant product pitches from digital banks compared to traditional banks, as well as fewer interactions in general.

5. **Highly convenient:** Digital banks optimize customer interaction through partnerships with retailers (which replace branches) and virtual customer service.

Preventing full transitions

Of course, it takes time for customers to fully transition to digital banks. (None of the participants in Amdocs' qualitative research, for example, had moved to use a digital bank 100% exclusively.) There are several reasons for customers' reticence to go all in.

1. **Not yet established:** Customers expect resilient financial institutions. Several digital-only banks lack a proven history, impacting legitimacy.

2. **Security concerns:** Recent breaches and a fleeting sense of security in all online spaces slow digital-only bank account adoption.

3. **Physical gaps:** Many customers still need physical financial products (such as checks and cashier's checks), and digital banks' cash deposit limits can be a major pain point for higher-income customers.

But just because customers are hesitant to become exclusive with digital banks, that doesn't mean their relationships with them aren't growing.

In our research, we found that people aren't committing fully to digital banks. They're testing to see if it meets their needs. For instance, people are opening small accounts to explore the experience. And then when they don't get hit with fees, they start getting comfortable and moving more money to the digital-only bank.

As customers become more comfortable, so does the relationship. People move from a small account to multiple accounts. Then, they begin to consider the digital bank for car, home and consumer loans. This slow pace is an opportunity for traditional banks to win back customers. The key? Match the experience of digital-only banks.

Responding to the challenge of neobanks

How are traditional banks confronting the challenge of digital-only banks? Some are creating their own all-digital brands. But that's not the only option. Read an article that explores strategies for competing with digital banks.

In Conclusion

Ultimately, traditional banks are facing rising competition from neobanks and are wise to pay attention to the growing trend of digital banking among consumers. Understanding some of the benefits digital-only banks deliver — such as always-on customer service — is key.

Customers' appreciation for customer service, as well as their growing trust in fintech solutions that solve their existing pain points, contributes to the neobanking trend. With a growing number of neobanking options available to consumers, they are earning an increasing share of primary financial relationships — and all banks should take notice.

Competing with digital-only banks starts with looking at trends in your industry, as well as analyzing your customers' issues and determining how to fix those problems — both from the business point of view and the technology and operational aspects behind it. A partner like Amdocs can help you develop your plans and reinvent the customer experience.

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