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The rise of neobanks and their impact on the banking sector

by Nicola Burgess

Churn is a term no bank executive wants to hear. But with the rise of neobanks in Australia, the customers need to be coming from somewhere.

Australia is still in its infancy when it comes to neobanks. Xinja, Up, Volt and Judo were established in 2017 and 86 400 in 2018. Places like the UK were early adopters, starting more than a decade ago under the digital bank banner. According to Medici Research, Oceania has only 3% of neobanks globally. Europe has 45% market share with 53 neobanks and the Americas 30% with 37.

In Europe digital-only banks are growing and taking considerable market share from traditional banks. A 2019 report by AT Kearney stated that European neobanks gained more than 15 million customers between 2011 and 2019; by 2023, neobanks are projected to have up to 85 million customers - equivalent to 20% of Europe's population.

One of the major reasons for the upsurge in neobanks in the UK is the Open Banking initiative that went live in 2018. This has helped digital banks such as Revolut, Starling Bank and N26 to establish themselves and challenge the incumbents. Open Banking was launched in Australia on July 1 this year - it will be interesting to see what impact this has on neobanks here.

Despite their infancy, neobanks are starting to make their mark. Judo raised $230 million in May taking its total funds raised to $750 million. Xinja declared that in the first seven days of operation $30 million was deposited with more than half of those customers coming from the Big Four.

86 400 recently announced that a year after gaining its banking licence from APRA it has more than 225,000 accounts, has undertaken more than $300 million in customer deposits and processed more than $1 billion in transactions.

While those numbers are dwarfed by the major banks which in 2019 held deposits of $1.54 trillion, they have had many decades to get to where they are.

Australians are spoilt for choice when it comes to banks. We have over 60 to choose from whether they are traditional banks, credit unions, mutual banks, building societies and now the neobanks.

As competition increases, it forces all financial players to innovate. The incumbents will have no choice but to also improve their product offerings and digital capabilities, enabled by technology to better service their customers.

The one thing that may be slowing the defection from the Big Four is that during times of uncertainty as we are currently facing, customers tend not to switch, preferring to stick with what they know.

Undoubtedly there will be winners and losers from COVID-19. The winners will be those organisations that maintain their trust quotient with customers but also embrace opportunities around digital engagement with customers.

To this end, the majority of banks have provided significant relief for customers affected by the pandemic. According to the Australian Prudential Regulation Authority, payments on mortgages worth a total of $192 billion were deferred in the period to 31 May equating to 11% of all residential mortgages.

The heritage of our business has been working with Australia's alternate banks primarily member-based organisations. Their customer churn rates haven't been anywhere near that of the major banks, owing to their loyalty and community appeal. Many of the mutuals are 100% customer owned such as Bank Australia, Beyond Bank and Defence Bank, which was created for Australian Defence Force employees.

As customers, the way we interact with our bank is constantly changing. Already the use of cash is vanishing thanks to COVID-19. ATMs are forecast to go the same way as the telephone box. Bank branches are also reducing in line with customer take-up of online channels. During the royal commission, senior executives of the major banks highlighted that bank branches were becoming uneconomic as consumers opted to bank online. For instance, in the decade leading up to 2018, ANZ closed around 110 branches and a further 20 in 2019 alone. More recently NAB announced it was reducing the opening hours of 115 regional bank branches by 50%. These trends are expected to accelerate across the entire banking sector.

Disruption of the existing model is varied and will continue. Innovation and responding to the evolving needs of customers is key. We have already witnessed the creation of wearable tech with the example of payments that can be made via wristbands, fitness trackers, watches, jewellery and even smart clothing. The winners in the sector will be those financial institutions that are able to embrace change and adapt swiftly. As the power base continues to shift it is incumbent on banks of all sizes to provide customers with greater choice and control over their interactions and transactions.