



Finnovate

# Finnovate Research

*ideas for financial innovation*



## NEO BANKS - PERFORMANCE AND NEW IDEAS

OCTOBER 2018

Accelerated expansion in customer base, innovative revenue generation & monetization models and increased M&A activity would carry digital banks into a higher league

### The 'Neo Banks' Growth Story

- Neo & Challenger Banks are redesigning their business models around customer-centricity, for significant user growth. A few of them such as Chime, Revolut, N26 and Compte-Nickel have acquired a **million-plus user base with total transactions value running into \$4-\$18 Bn.**
- The Digital Banks are also leading on customer satisfaction metrics. US Digital Banks' customers are **83% satisfied** as against **76% satisfaction rate** for UK customers. In both the markets, customers report the lowest satisfaction with Top 50 Global banks.

### Business Model & Competitive Levers

- Neo banks are challenging the universal banking model through a **low-cost structure, feature-rich products/services** and **easy accessibility.** Their Innovation engine focuses on three key pillars – Customer experience, User convenience and Simplified processes. **Platform-centric models via open banking and APIs** is also enabling Neo banks to expand user base, growing commission income and in offering increased potential for data monetization.
- The Neo & Challenger banks have a **strong cost efficiency** driven by less complex IT systems, simpler product set, lower real estate and distribution costs and more streamlined operating models
- **Demand-pull** for Neo & Challenger Banks is rooted in their ability to offer a faster and transparent model, lower fees, superior CX and a goal-oriented business aimed at improving household financial wellness.

### Near-Term Strategic Threats to Mainstream Banks

- In the near term, the **disruption risk remains significant** for **retail and basic banking services**, which are transactional in nature. For advisory services such as financial planning and wealth management, most of the existing robo-advisory platforms currently address only a part of the value chain, geared towards portfolio creation and execution. A **full-fledged robo-advisory** service is likely to have a significant impact
- For mainstream banks, the biggest threat comes from **full-stack neo banks** such as Monzo, Starling Bank, N26, Tandem and Atom Bank. Armed with an asset-light model, platform-centric business, proprietary technology systems and a banking license, they control most of the value chain from front-end to back-end

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# Performance and Satisfaction Analysis

# A FEW NEO-BANKS ARE ATTRACTING A LARGE USER BASE

As big banks have been slower to adapt to new technologies and changing customer needs, start-up digital banks have been amassing a large user base who are actively using their services. Chime, Revolut and N26, in particular, have acquired a million-strong user base with total transactions amounting to billions of USD.

DIGITAL BANK	LAUNCH	TOTAL USER BASE	USER GROWTH RATE	TOTAL TRANSACTION VALUE	TRANSACTION ACTIVITY
Revolut	2014	Over 2 million	8,000	US \$18 billion	US \$1,000 per user per month
Chime	2013	Over 1 million	3,500	US \$4.5 billion	40 transactions per user per month
N26	2014	Over 1 million	2,500	US \$10 billion	US 1.17 billion per month
Compte-Nickel*	2010	Under 1 million	650	US \$4.5 billion	40 million total transactions

\*Compte-Nickel was acquired by French bank BNP Paribas in April 2017

continued...

## HOWEVER...

Not all neo-banks are enjoying performances that are as stellar:

DIGITAL BANK	LAUNCH	TOTAL USER BASE
Lidya	2016	Over 120,000
Open	2017	Around 1,000
Countingup	2018	Around 1,000 (500 acquired within 3 weeks)
Loot	2014	Over 100,000
Tandem	2013	Over 100,000
Nuo	2018	20,000 (acquired within 2 days)

And not all reported sign-ups are indicative of 'actual' usage and activity:

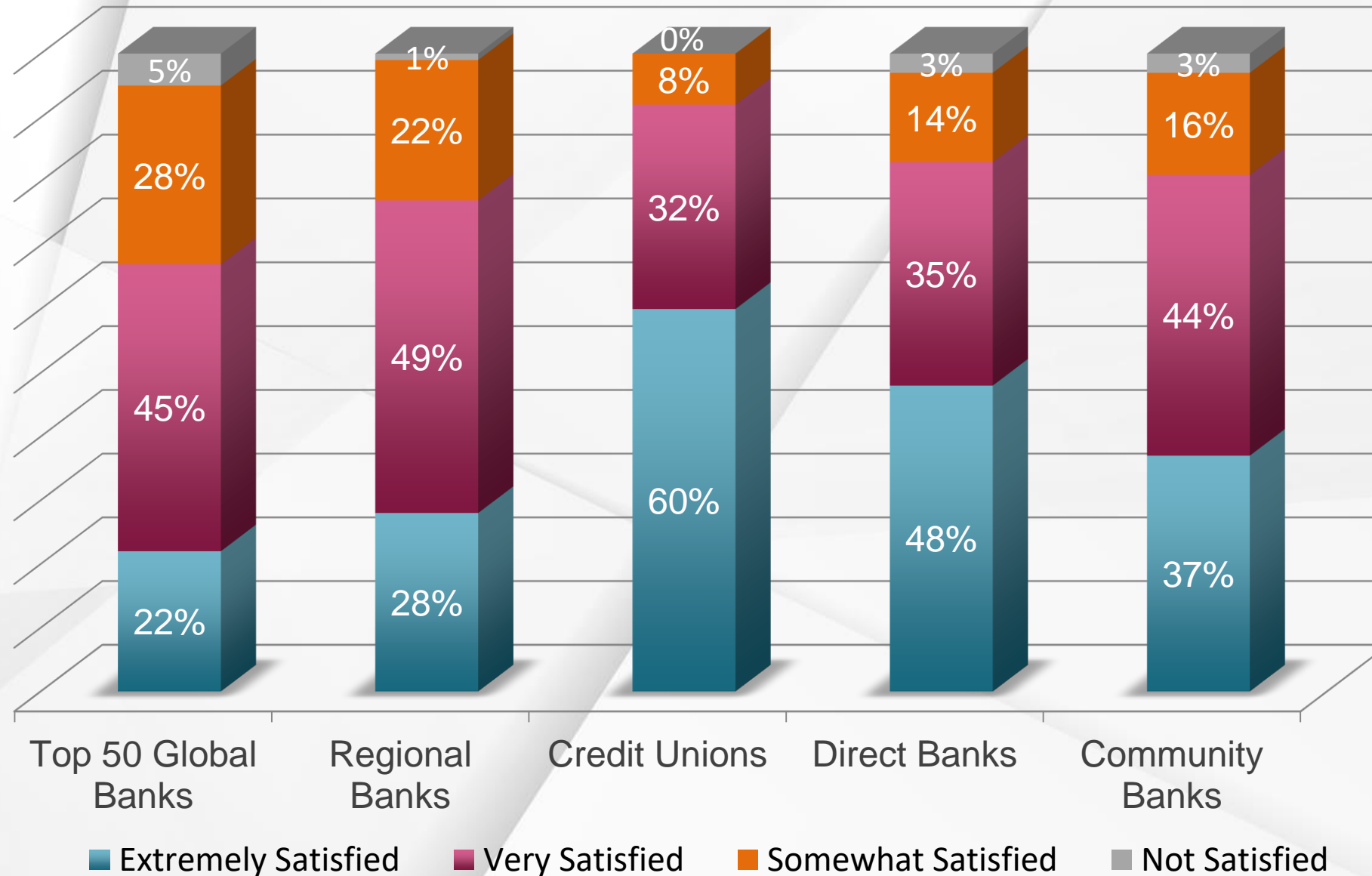
- Usage statistics reveal neo banks' customers are at least **as active\*\* as those of legacy banks**
- At Starling, 60% of customers use their accounts at least once a month with an average of £900 in deposits
- At Monzo "more than 45% of customers are putting at least £500 a month into their accounts"

\*\*most large UK high street banks define an "active" customer as one who has used their account in the last three months

# NEO-BANKS FEED ON LOW SATISFACTION WITH MAINSTREAM BANKS

## Customer Satisfaction by Bank Type—US

US banking consumers are most satisfied with Credit Unions and least satisfied with Top 50 Global Banks.



US Credit Union members are the most satisfied, while customers from Top 50 Global Banks are least satisfied with their banks

Direct Banks' customers are 83% satisfied as against 67% satisfaction rate for Top 50 Global Banks

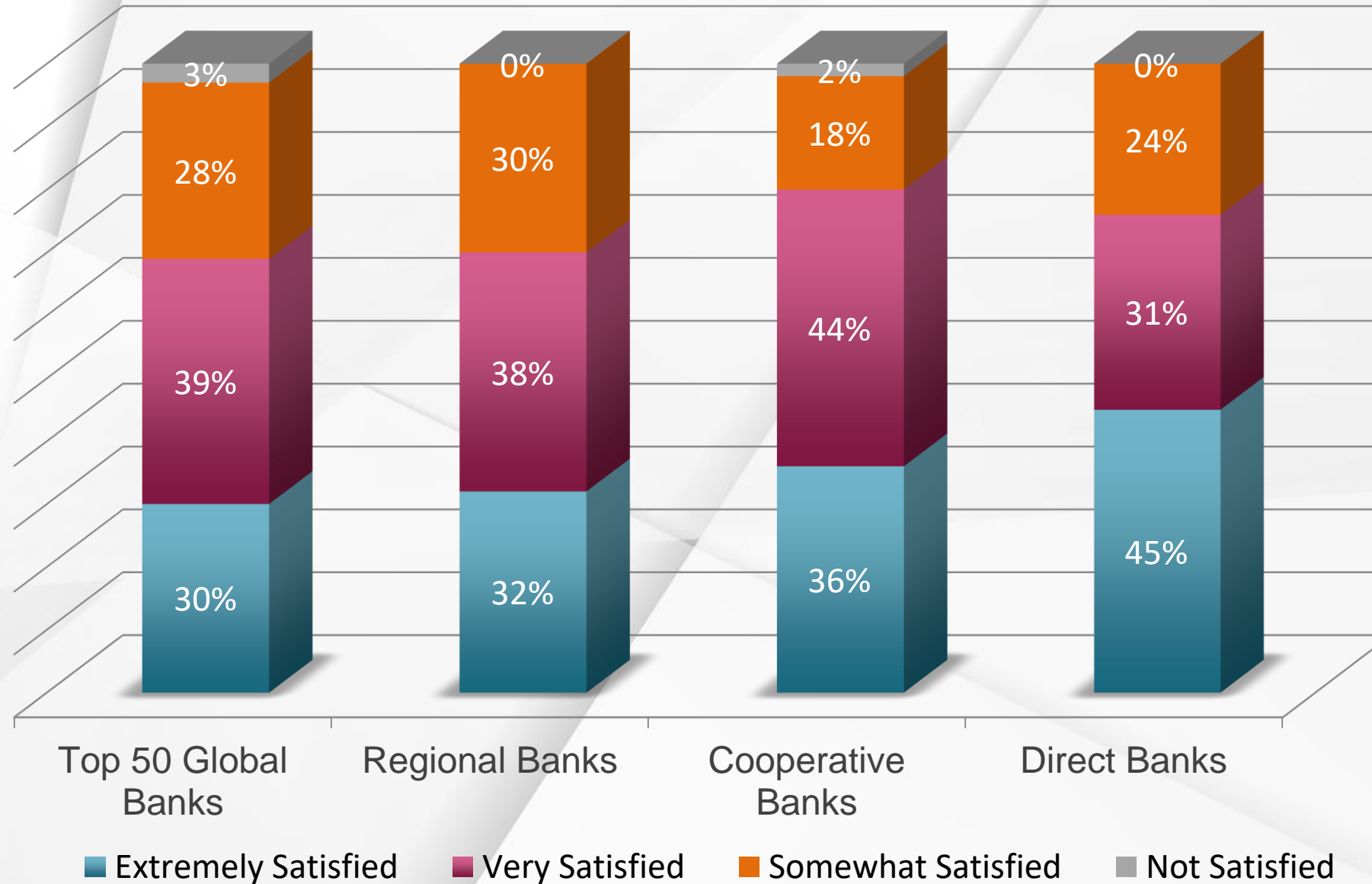
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# UK DIRECT BANKS EARN HIGHEST SATISFACTION RATING

## Customer Satisfaction by Bank Type—UK

UK consumers report the highest satisfaction with Direct Banks while they are least satisfied with Top 50 Global Banks.



UK customers of Top 50 Global Banks are much less satisfied compared to Regional, Cooperative and Direct Banks

Direct Banks report the highest satisfaction among customers, followed by Cooperative Banks



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# Innovation Themes

# NEO BANKS FOCUS INNOVATION ON CX, CONVENIENCE AND SIMPLIFIED PROCESS

Neo banks are challenging the universal banking model with their lower costs, personalized insights, predictive intelligence, user-friendly interfaces, easy accessibility and simplified processes

1

## Customer Experience



Some consumers feel that their finances were better understood, better guided and better managed by alternative banking providers, such as challenger banks and neo-banks

2

## User Convenience



Consumers are demanding ever-more consistent and convenient banking experiences, with an increasing preference for a mobile user interface instead of a physical location or bank personnel

3

## Simplified Process



Consumers are willing to try new banking platforms in order to save money and to simplify financial transactions

# 1. CUSTOMER EXPERIENCE

## Interchange Fee Based Model Minimizes Front-End Friction

Neo-banks prioritize customer needs and circumstances – structuring their products and services in a way that is empowering instead of punitive.



Use of Interchange Fee model to minimize customer-facing fees, such as monthly fees, minimum balance fees, and overdraft fees

**Chime** earns ~1.5 percent in interchange revenue from Visa through its accompanying debit card

**N26** generates interchange fees from merchants

## Spending Analysis and Controls

Focus on PFM with real-time insights

**Loot** lets customers know how much they can spend freely

**N26** sends push notifications on all account activity (e.g. card payments, ATM withdrawals)

**Tandem** and **Personetics** provide personalized insights on money management

## AI Credit Scoring Enables Smoother and Faster Decisions

Use of AI models and analytical engines to enable faster decisions

**Lidya** uses nearly 100 data points to assess the credit worthiness of applicants. Repayment schedules and fees are agreed upon upfront without the need to visit physical branch.

## 2. USAGE CONVENIENCE

Digital banks are creating convenient ways of accessing banking needs by tapping into local ecosystem, collaborating with technology specialist firms and embedding AI-based capabilities into their offerings.



### Location-Agnostic Banking

Anywhere, anytime models  
Banking through Digital Venues as against Physical Branches  
Round-the-clock access on-the-go

**Compte-Nickel's** partnership with tobacconists/newsstands for deposits, balance updates, etc.

### Collaboration

Partnerships with local/global banks and FinTechs for expanded cross-sell  
Re-bundling services through tight-knit integrations, Services Integrator model

**Lunar Way** Travel Card's app links to a pre-paid multi-currency MasterCard  
**Alior, Solaris, Raisin** and **Mastercard** together will create an open banking platform based on APIs.

### Automated Accounting and Cash-flows

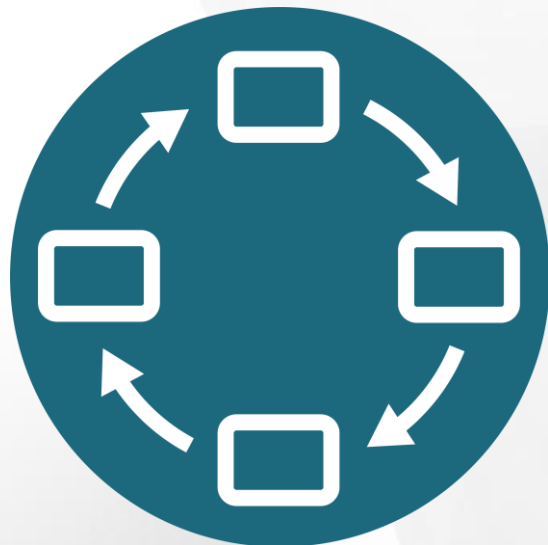
Targeting SMBs, freelancers  
Core features: Accounting, Tax, and Business reporting

**OPEN** offers automated bookkeeping and expense management for SMBs

**Countingup** enables instant, automated expense recording with real-time insights into the health of the business.

### 3. SIMPLIFIED PROCESS, TIME AND COST SAVINGS

Digital banks are helping users save money, especially on international transactions, and to better manage their finances, all without physically transacting with a bank



#### Low Cost Exchange Rate

Fast, secure, low-cost international purchases/transfers using the mid-market exchange rate

**Revolut** customers can spend in over 90 currencies at the best exchange rate available with no fees

**Alior Bank** will offer multicurrency accounts with international transfers and deposits

#### Quick and Paperless Sign-Up

Seamless customer onboarding experience

Open user accounts via mobile or web within a few minutes and with minimal requirements

**Revolute:** 3 minutes

**N26:** 8 minutes

**Countingup:** 5 minutes

#### Free ATM Withdrawals

Secure and free cash withdrawals from a global network of ATMs

**Chime** has a network of 40,000 free ATMs

#### Savings

'Zero fee-account' model to promote savings

**Xinja**, the Australia-based startup, will combine real-time payments with the option to save money for specific purposes without having to open a separate account



3



# Strategy and Business Model





# NEO BANKS ADOPT PLATFORM-CENTRIC MODELS AS AGAINST PRODUCT-CENTRIC MODELS OF INCUMBENTS

Neo Banks are creating an ecosystem of services around their infrastructure, shifting the banking value from branches to their API layer. They are reshaping the business model by offering Banking-as-a-Platform.

## Incumbents' Model PRODUCT-CENTRIC

## Neo-Banks' Model PLATFORM-CENTRIC

### BRANCHES

### MARKETPLACE COMMUNITY

- High verticalization of products
- No strong communities around the brand/product
- Large branch/network
- High customer acquisition cost

- High community engagement with the product
- Horizontalization of products with best-in-class apps
- Open banking through APIS
- Mobile only (low customer acquisition cost)

### TECH INFRASTRUCTURE

### TECH INFRASTRUCTURE

- Outsourced technology
- Rigid legacy platforms of 1970s–1980s
- Non-modular architecture with limited scalability
- Hard to integrate data from 3<sup>rd</sup> party providers

- Open architecture technology stack
- Ability to 'plug and play' best-in-class tools/services
- Low dependency on 3<sup>rd</sup> party providers
- Open ecosystem allowing access to external developers

### PRODUCT-CENTRIC BUSINESS

### DATA-DRIVEN BUSINESS

- Banking data divided into silos
- Mix of paper-based and online data
- Difficulties in reconciling, monitoring data

- Real-time data integration and management
- Current accounts generate key data for 3<sup>rd</sup> parties
- Data powers business model through 3<sup>rd</sup> party affiliation fees

### ORGANIZATIONAL DESIGN

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- Product-centric organizational design
- Products and verticals drive organization structure

- Customer-centric organizational design
- Customer needs drive data architecture

# MOST NEO-BANKS HAVE HIGH COST EFFICIENCY

Neo and Challenger banks have less complex IT systems, simpler product set, lower real estate and distribution costs, more streamlined operating models and few legacy compliance issues compared to traditional banks. Achieving profitability, however remains a challenge, given rising pricing pressure.

## Lower Customer Acquisition Costs

- Average challenger bank's cost of customer acquisition ranges from **\$1 to \$38** compared to about **\$200** for traditional retail banks.
- Monzo spends ~£6 (\$8.37) per customer if a person uses it as their primary account.
- Customer acquisition effort driven largely by viral marketing and social media.

## Back-End Outsourcing

- Several challenger banks such as N26 and Tandem have **outsourced back-end technology** stacks resulting in lower capital expenditure and faster time-to-market.

## Price Competitiveness

- UK challenger banks **pay roughly twice the savings rate** of traditional banks (0.92% versus 0.44% for the average easy access account).
- In the US, rates on deposits are three times higher at online/digital banks compared to traditional banks (0.79% versus 0.27% for a 12-month CD).

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# ACHIEVING PROFITABILITY REMAINS A KEY CHALLENGE



## Operating Efficiency

- Neo and challenger banks have an average **cost efficiency ratio of 46%** compared with a range of **50-60%+** for most traditional banks.
- The smaller challenger banks have achieved lower cost-to-income ratios due to rapid growth in total assets.

## Distribution and Channel Costs

- Challenger banks adopt distribution models that do not utilize a branch network.
- Distribution costs typically run at **6% of their overall cost base**, compared to an average of **27%** across the retail banking industry.

## Profitability

- UK challenger Monzo's prepaid card scheme **loses around £50 per active customer per year**.
- Large volume of current accounts with their low average balances are inherently unprofitable.
- N26 closed 160,000 customer accounts as users were making too many ATM withdrawals, pushing up costs for the bank.

# APIs ARE A FORCE MULTIPLIER FOR NEO-BANKS

Neo Banks are embracing APIs to create new financial products & services

Neo-banks are embracing open APIs as it enables them to offer a seamless experience for their users and also to explore opportunities for expanding their revenue and customer streams.

## Marketplace

Starling Bank and Monzo's partnership involves building a **marketplace** of financial products and services, which offers users with:

- A curated selection of the best money-related apps
- Open APIs to allow other developers and FinTechs to build functionalities on top of their infrastructure
- Positive user experience and higher transaction activity

## Integration with Third-Party Platforms

Monzo's integration **with 3<sup>rd</sup>-party API platforms** offers additional functionalities:

- TrueLayer's financial APIs enables business users to swiftly and securely request access to account data from Monzo
- IFTTT's automation platform allows Monzo's users to connect to other apps & devices

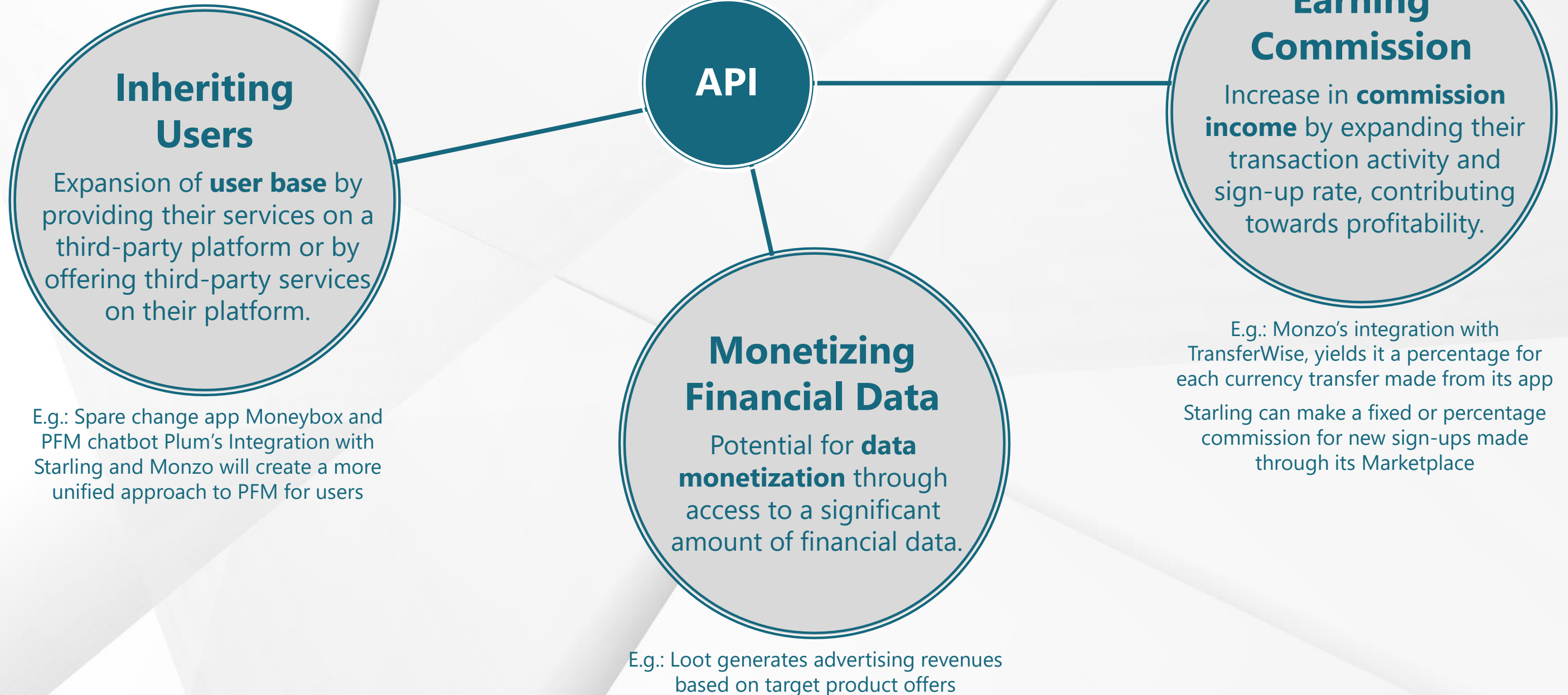
## Categorization Engine & Smart Nudges

Integration with **Moneyhub**, offers users of Starling and Monzo access to its proprietary categorisation engine and Smart Nudges towards making well informed monetary decisions

continued...

# APIs ARE ENABLING NEW REVENUE STREAMS AND CUSTOMER ACQUISITION

## Three-Pronged Benefits to an API Model







4

# Adoption Drivers and Attributes: Comparative Analysis



# ATTRIBUTES INFLUENCING THE CHOICE OF A BANK

**UK** Consumers Rank Trust & Digital Self-service The Highest **US**

UK consumers overall value their needs for Trust and Control most, but consumers in the Millennials segment see Digital Self-service as more important.

US consumers value Trust and Simplicity the most, while young millennials rank Digital self-service as more important.

RANK	UK			US			RUN FACTORS
	YOUNG MILLENIALS (18-26)	GEN Xers (38-52)	BABY BOOMERS (53-71)	YOUNG MILLENIALS (18-26)	GEN Xers (38-52)	BABY BOOMERS (53-71)	
1	<b>Trust</b>	<b>Digital Self-Service</b>	<b>Trust</b>	1	<b>Trust</b>	<b>Trust</b>	Trust, Simplicity, Convenient Locations
2	<b>Control</b>	<b>Trust</b>	<b>Control</b>	2	<b>Digital Self-Service</b>	<b>Digital Self-Service</b>	
3	Digital Self-Service	<b>Control</b>	Simplicity	3	Simplicity	Convenient Locations	CONNECT FACTORS
4	<b>Digital Payment</b>	Simplicity	Human Touch	4	<b>Control</b>	Simplicity	
5	Simplicity	Convenient Locations	<b>Recognition</b>	5	<b>Digital Payment</b>	Human Touch	Digital Self-Service, Human Touch, Immediate Access
6	<b>Recognition</b>	Human Touch	Convenient Locations	6	Convenient Locations	<b>Control</b>	
7	Convenient Locations	<b>Recognition</b>	Digital Self-Service	7	Human Touch	<b>Digital Payment</b>	GROW FACTORS
8	Human Touch	<b>Digital Payment</b>	<b>Digital Payment</b>	8	<b>Recognition</b>	<b>Recognition</b>	
9	Immediate Access	Immediate Access	Immediate Access	9	Immediate Access	Immediate Access	Recognition, Digital Payment, Control

# CONSUMERS MOSTLY PREFER NEO BANKS FOR SPEED, TRANSPARENCY AND UX

Neo banks' ability to offer faster and transparent model along with their low-cost structure and superior UX are key factors influencing customers' growing preference for them over traditional banks.

Choice Factor (Core)	Description	Relative Preference
<b>SPEED</b>	<ul style="list-style-type: none"> <li>Fast and simple account opening (3–7 minutes)</li> <li>Simple form filing, direct video call</li> </ul>	
<b>TRANSPARENCY</b>	<ul style="list-style-type: none"> <li>No hidden fees, monthly charges, minimum balances</li> </ul>	
<b>LOWER COSTS</b>	<ul style="list-style-type: none"> <li>Minimum/No fees like overdraft and monthly fees</li> <li>No foreign ATM fees</li> </ul>	
<b>USER EXPERIENCE</b>	<ul style="list-style-type: none"> <li>100% digital and mobile platform</li> <li>Feature-rich apps and tools</li> </ul>	
<b>IMPROVED FINANCIAL WELLNESS</b>	<ul style="list-style-type: none"> <li>Smart ways to help households save</li> <li>Spending analytics and advice</li> </ul>	



Notes:

1. The relative preference assessment is based on Finnovate's qualitative analysis of individual choice factor

2. Core factors are primary attributes influencing customers' choice of Neo-banks

continued...

# NEO BANKS ALSO OFFER VALUE-ADDED SERVICES TO ATTRACT NEW CUSTOMERS

Optichannel experience, value-added services and next-generation customer support are other factors driving customers' adoption of Neo-banks.

Choice Factor (Add-on)	Description	Relative Preference
<b>MICRO SEGMENTS INCLUSION</b>	<ul style="list-style-type: none"> <li>SMBs, gig economy, lower-income households, women</li> <li>Socially-conscious banking/impact lending</li> </ul>	
<b>NEXT-GEN CUSTOMER SUPPORT</b>	<ul style="list-style-type: none"> <li>Chatbots, video banking, and interactive content</li> <li>Real-time customer service</li> </ul>	
<b>LIFESTYLE BANKING</b>	<ul style="list-style-type: none"> <li>A-la-carte model catering to lifestyle and preferences</li> <li>Network of tools to help achieve financial goals</li> </ul>	
<b>OPTICHANNEL EXPERIENCE</b>	<ul style="list-style-type: none"> <li>Optimal channel-mix designed to each customer</li> <li>Data integration engine for unified customer view</li> </ul>	
<b>VALUE-ADDED SERVICES</b>	<ul style="list-style-type: none"> <li>International payments</li> <li>Multi-currency accounts</li> <li>Cryptocurrencies and gamified banking</li> </ul>	

Notes:

1. The relative preference assessment is based on Finnovate's qualitative analysis of individual choice factor

2. Add-on factors are secondary attributes influencing customers' choice of Neo-banks

● Mainstream Banks  
● Neo Banks



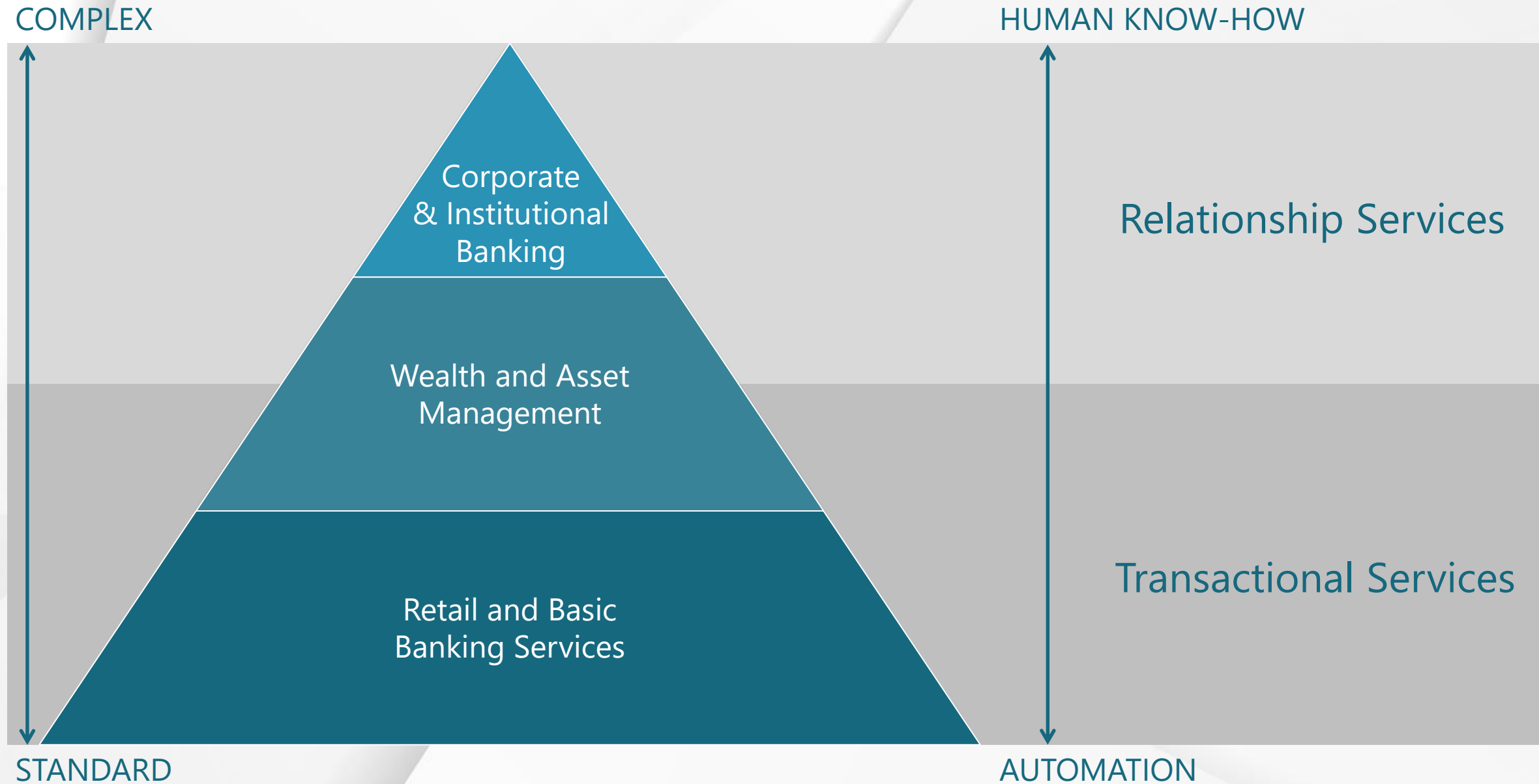
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# Market Impact and Outlook

# RETAIL BANKING SERVICES HAVE HIGH DISRUPTION RISK

## The Disruption Continuum

In the near-term, the disruption risk remains significant for retail banking services which are largely transactional in nature.

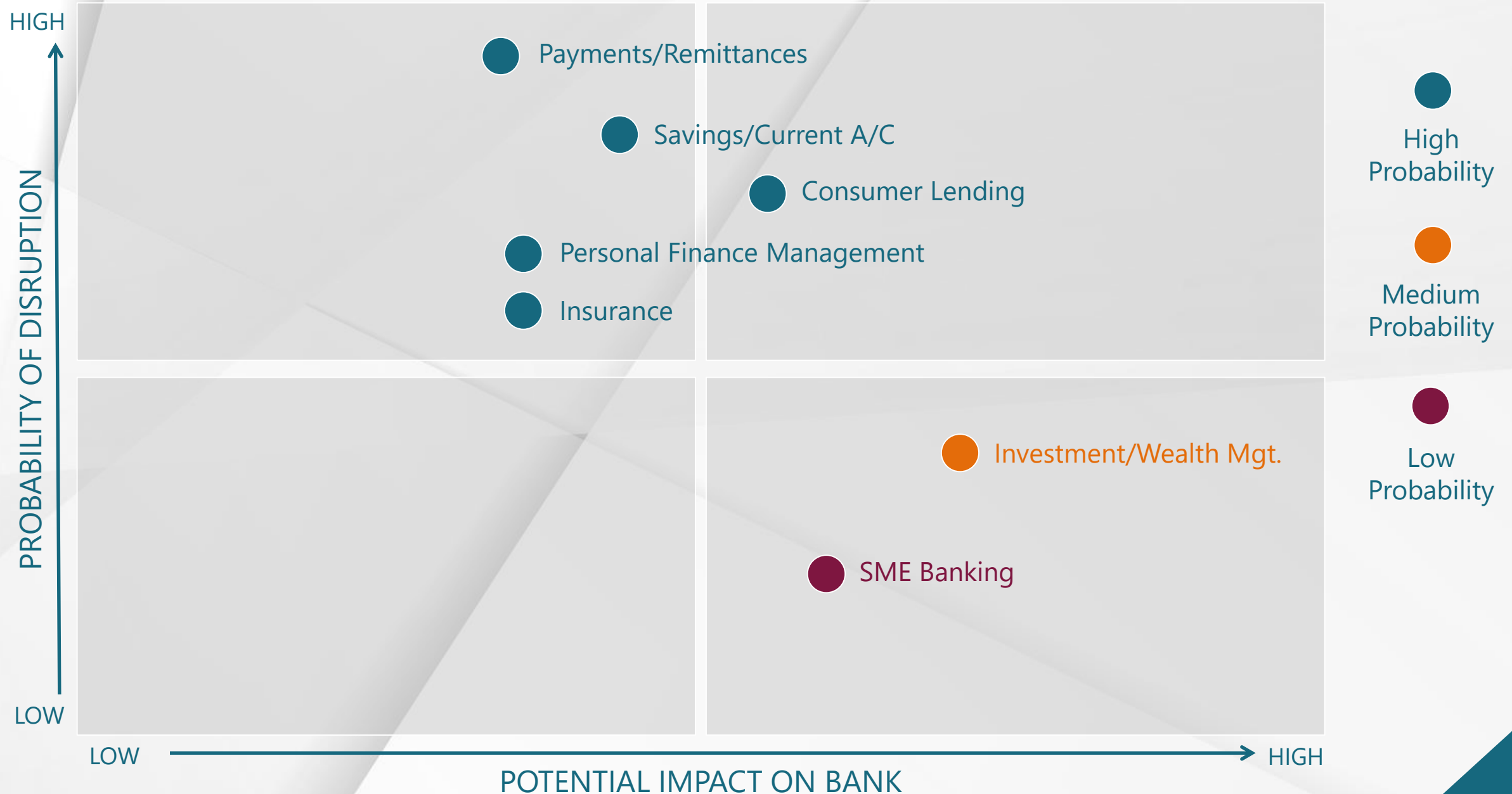


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# DISRUPTION IMPACT CAN BE SIGNIFICANT FOR SME BANKING & WEALTH MGT.

## Disruption: Impact v. Probability Matrix

The Digital banks are mastering most of the banking value chain from back-end to front-end in order to deliver superior customer-centric product based on a lean approach, asset-light and platform-based model.





# FULL-STACK NEO BANKS POSE BIGGER THREAT TO MAINSTREAM BANKS

Full-stack Neo Banks are building the entire technology stack from scratch in-house, leveraging data and analytics for fuelling innovation and are employing a lean model, thereby offering greater control and flexibility to respond to customer needs.

## Full-Stack Neo Banks

- Built on Platform model
- Have a banking license
- Control most of the value chain from front-end to back-end
- Use a lean/asset-light approach
- Have their own/proprietary CBS
- Leverage unsoiled data to gain customer insights/offer personalized services

## FEATURES

Asset-Light Platform



Full Services (In-house)



## Front-End Focused Neo Banks

- Do not have a banking license
- Partner with a larger/established bank
- CBS/tech systems are off-the-shelf or sourced externally
- Control only front-end of the value chain (customer interface)
- Support B2C and B2B apps
- Target niche segments (young millennials, SMBs, Entrepreneurs)

## FEATURES

B2C

Targets Young People



Basic Banking Services

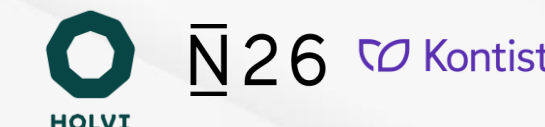


B2B

SMB Focus



Solo Entrepreneur



Accelerated growth in customer expansion, innovative revenue generating & monetization models, increased M&A activity are expected to catapult digital banks into the next league

Trend	Current Scenario	Outlook/Forecast
<b>AGGRESSIVE EXPANSION</b>	<ul style="list-style-type: none"> <li>The U.S. accounts for ~4/5th of the global neo bank market in terms of customer base in 2016</li> <li>UK holds one-fifth share</li> </ul>	<ul style="list-style-type: none"> <li>Customer base expected to grow at CAGR of 51% from 2017–2020.</li> <li>Global market to reach \$356 million by 2025</li> </ul>
<b>SHIFT IN FOCUS TO PROFITABILITY</b>	<ul style="list-style-type: none"> <li>Most banks in a net loss-generation phase</li> <li>Current focus on customer acquisition</li> <li>Growth supported by VC funding</li> </ul>	<ul style="list-style-type: none"> <li>Monetization of key services (E.g.: N26 monetizes new users on card issuing, ATM withdrawals)</li> <li>Freemium model expected to grow</li> </ul>
<b>INNOVATIVE REVENUE MODELS</b>	<ul style="list-style-type: none"> <li>Partnership strategy and co-branding model</li> <li>Moven has teamed up with CBW Bank, TD Bank, and Westpac NZ</li> </ul>	<ul style="list-style-type: none"> <li>Expansion of non-interest income through:                             <ul style="list-style-type: none"> <li>3<sup>rd</sup> party partnerships</li> <li>value added services beyond banking propositions</li> </ul> </li> </ul>
<b>CONSOLIDATION</b>	<ul style="list-style-type: none"> <li>Heightened consolidation among UK's larger challenger banks driven by:                             <ul style="list-style-type: none"> <li>rising costs, increased competition, and a sluggish economy.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Wider focus on boosting growth through purchase of specific assets</li> <li>Falling valuations to provide additional catalyst for deal making</li> </ul>
<b>ACQUISITION BY LARGER BRANDS</b>	<ul style="list-style-type: none"> <li>Traditional full-service banks buying into new banks (E.g.: BBVA's acquisition of Finnish neo bank Holvi and US neo bank Simple)</li> </ul>	<ul style="list-style-type: none"> <li>Accelerated pace of M&amp;A, giving incumbent banks quick time to market</li> <li>Product focus to lean towards entrepreneurs, SMB lending and consumer mortgages</li> </ul>

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# Appendix

# IBANKS: FOCUSED ON STRONG TECH & DATA MONETIZATION

iBanks have a strong technology platform and generate revenues from targeted marketing through data monetization

## Business Model

- Offers better and more customized services
- Generate additional revenues from targeted marketing through data monetization
- Need to pay a partner bank

## Examples

- Loot (Loot.io) which caters to university students offers promotional offers, automated discounts and other personalized offers on its mobile app
- Makes money through advertising
- Lower banking fees for customers

## Key Challenges

- Customer acquisition
- Dependence on partner bank (IT/costs)
- Data monetization in financial services



- [Monzo, revolut and other challenger banks are shaking up the industry](#)
- [UK startup bank tandem partners with personetics to deliver ai-powered everyday banking that puts customers first](#)
- [UK digital challengers beating high street banks on customer satisfaction](#)
- [Why big UK banks are worried about open banking](#)
- [1 million customers: inside neobank chime's growth strategy](#)
- [Sony's adorable new aibo comes to the US](#)
- [N26 now has 1 million customers](#)
- [Full-stack neobanks are taking the retail banking market to the next level](#)
- [The digital disruption battlefield](#)
- [How much scale does your business need?](#)
- [Fintech start-up revolut grabs 2 million users and plans to launch commission-free trading service](#)
- [No-fees mobile bank chime raises \\$70M series C, valuing its business at \\$500M](#)
- [German challenger bank N26 reaches 1 million users on the heels of U.S. Launch](#)
- [The most successful neobank is french, but it is \(still\) mostly unknown in the rest of europe](#)
- [Digital neo-bank start-up loot secures £2.2m in series A round](#)
- [Challenger bank tandem lands 100,000 users in just five months, sets sights on Lloyds](#)
- [What is lidya?](#)
- [The digital disruption battlefield](#)
- [Neo and challenger bank customer base to grow by 50.6%, globally, by 2020](#)
- [Finding a business model for challenger banks](#)
- [Neo and challenger bank market by type of bank \(neo bank and challenger bank\) - global opportunity analysis and industry forecasts, 2016-2020](#)
- [The business models of banking 2.0](#)
- [CHALLENGER BANKS: LOOKING AHEAD TO EXPANSION AND EVOLUTION IN 2018](#)
- [How Many Customers Do Fintechs Really Have?](#)
- [KPMG: Challengers surge ahead, but obstacles remain](#)
- [Neo Banks aim to improve consumer financial health](#)
- [Neo banks might destroy traditional banks or launch the next wave of growth](#)
- [Neo banks - tomorrow's banking has arrived](#)
- [Who wants to bank with a Digital Bank?](#)
- [2018 PACE Insights: UK consumer](#)



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