Neobanks: The Profitability Paradox

Your bank was built before the internet – so why hasn't it disappeared?

Digital Finance

Why Would a Tech Company Want to Become a Bank?

The Paradox

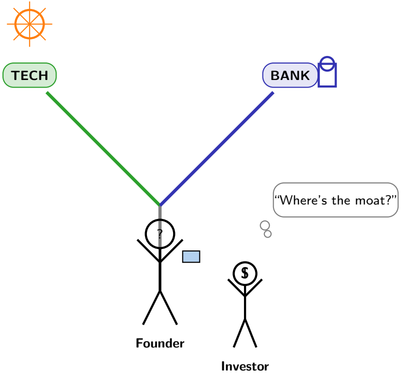
Banking is slow, regulated, and expensive to enter. Technology companies avoid regulation. Yet dozens of startups have chosen to build banks from scratch.

What makes banking attractive to disruptors?

- Payments generate data on every transaction
- Deposits provide cheap capital (if licensed)
- Customer relationships are sticky once established
- Incumbents are slow – legacy systems built decades ago

What makes banking terrifying?

- Licensing takes years and millions in capital
- Compliance costs never stop growing
- Revenue per customer is surprisingly low
- Trust takes decades to build, seconds to lose



Banking is the most regulated industry on earth.
Why would anyone choose to enter it?

The most regulated industry attracts disruptors because incumbents are trapped in legacy – regulation is both the barrier and the opportunity.

Opening a New Account – Did Friction Even Cross Your Mind?

Reflection Prompt

Think about the last time you opened a financial account – a bank account, a payment app, a trading account.

How long did it take? Five minutes on your phone? Or did you visit a branch, bring documents, and wait days for confirmation?

If you opened it on your phone in under ten minutes, you probably used a digital-only provider – whether you realized it or not.

Consider these everyday moments:

- Splitting a dinner bill instantly through an app
- Getting a real-time notification the moment you tap your card
- Seeing your spending categorized automatically by the end of the day
- Sending money abroad without visiting a currency exchange

Each of these was impossible with a traditional bank a decade ago. The question is not whether the experience is better – it is. The question is whether **better experience alone** can sustain a business.

Neobanks win on experience. The open question is whether experience alone generates enough revenue to survive.

What Makes a Neobank Different from a Digital Bank?

Dimension	Neobank	Challenger Bank	Digital Arm
Origin	Born digital	Born digital	Incumbent spin-off
License	Often e-money	Full banking	Full banking (parent)
Branches	None	None or minimal	Parent has branches
Core system	Cloud-native	Cloud-native	Often legacy
Deposit insurance	Usually no	Yes	Yes (via parent)
Lending	Limited or via partner	Full lending	Full lending
Revenue model	Fees, interchange, FX	Fees + lending	Cross-subsidy from parent
Primary advantage	Speed, UX, cost	UX + full product suite	Trust + digital convenience
Primary weakness	Narrow product, no moat	Profitability timeline	Legacy system constraints

The critical distinction is licensing

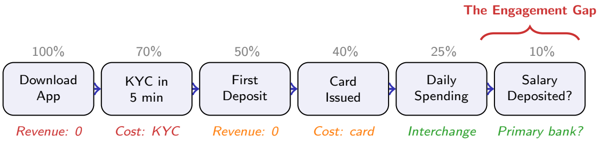
- **E-money license:** Can store and transfer funds, issue cards, BUT cannot lend deposited money or offer deposit insurance
- **Full banking license:** Can accept deposits, provide credit, participate in deposit insurance
- Many neobanks start with e-money licenses and later pursue full banking authorization

Why it matters for profitability

Without a lending license, the most lucrative revenue stream in banking – net interest income – is off limits. This is the core structural challenge.

Licensing determines the business model ceiling – without a lending license, the richest revenue stream in banking is off limits.

Follow One Customer from Download to Daily Use



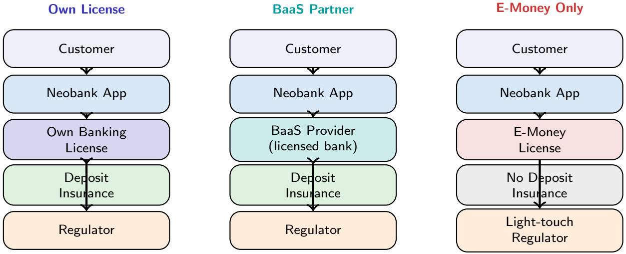
The funnel tells the story

- **Download to KYC:** Fast onboarding is the competitive advantage. Identity verification in minutes, not days.
- **First deposit:** Many users deposit a small amount to test. The neobank earns nothing yet.
- **Card spending:** Interchange fees (typically 0.2–0.3% in Europe) generate the first revenue. But per-transaction income is tiny.
- **Salary deposit:** The make-or-break moment. If the customer moves their salary, the neobank becomes the **primary bank**. If not, it remains a secondary "spending card."

The engagement gap: Most neobank customers never make it their primary bank. They keep their salary at the traditional bank and use the neobank for discretionary spending only.

Illustrative conversion rates based on published industry surveys. The engagement gap – failing to become the primary bank – is the central profitability challenge.

Who Should Hold the Banking License – the Neobank, a Partner, or Both?



Three licensing architectures

- **Own license** grants full control: the neobank can lend, earn net interest income, and build its own product stack. But compliance costs are high and the licensing process can take years.
- **BaaS (Banking-as-a-Service)** lets the neobank focus on the customer-facing app while a licensed partner provides the banking rails. Faster to market, but margins are shared and the neobank depends on the partner.
- **E-money only** is the lightest option: store and transfer funds, issue cards, no lending. Fastest to launch, but the revenue ceiling is low without lending.

The strategic question: At what scale does it make sense to invest in a full banking license rather than renting one?

The licensing architecture determines the revenue ceiling – own license enables lending, BaaS shares margins, e-money limits the product suite.

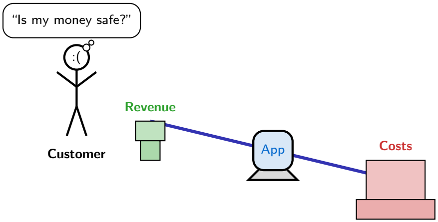
What Could Go Wrong If Your Neobank Runs Out of Money?

The Funding Cliff
Neobanks burn cash to acquire customers. When venture capital funding dries up before profitability arrives, the neobank faces a **funding cliff**: too many customers, not enough revenue, and investors unwilling to write the next check.

What could go wrong:

- **Regulatory withdrawal:** License revoked for compliance failures – customers lose access overnight
- **BaaS partner failure:** If the underlying licensed bank collapses, the neobank's deposits are at risk – and the neobank has no direct relationship with the deposit insurance scheme
- **Customer concentration:** If the neobank serves mostly low-value customers who never pay for premium features, unit economics never work
- **Fraud losses:** Fast onboarding means less friction for fraudsters too – fraud can spike before controls mature

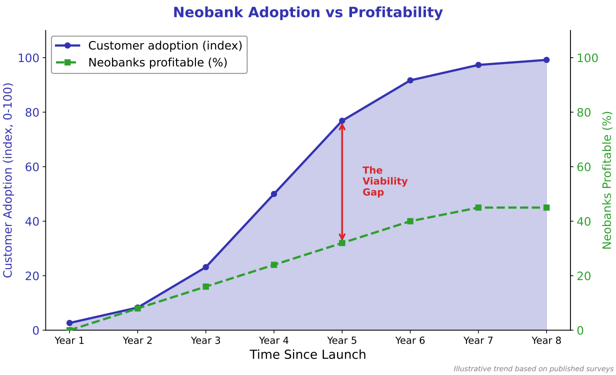
The trust problem: Traditional banks survived financial crises. Neobanks have never been tested in a prolonged downturn.



Growth without profit is a countdown.

A neobank that cannot fund itself from operations is always one funding round away from crisis – growth without profit is a countdown.

Why Are So Many Customers Adopting Digital-Only Banks?



Two trends, one tension

- **Adoption is surging:** Global digital-only bank users have grown from tens of millions to hundreds of millions in under a decade
- **Profitability lags far behind:** Only a small fraction of digital-only banks have reached sustained profitability
- The gap between the two curves is the central puzzle of the neobank industry

What drives adoption?

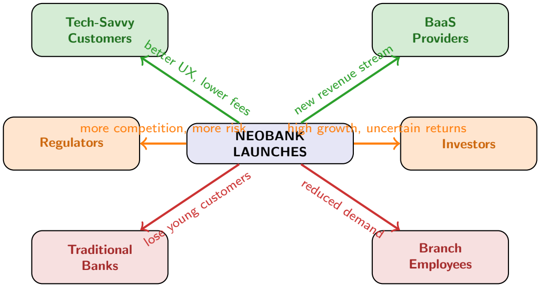
- Mobile-first populations in emerging markets
- Young demographics (under 35) in developed markets
- Pandemic-accelerated shift away from branches
- Multi-banking: most users keep their traditional bank

Why profitability lags:

- Low revenue per user (free accounts, capped interchange)
- Rising customer acquisition costs
- Regulatory compliance costs scale with user base

Illustrative trend based on published surveys. Adoption and profitability are diverging – more users does not automatically mean more profit.

Who Wins and Who Loses When a Neobank Launches?



Winners

- \+ **Tech-savvy customers:** Lower fees, better app, instant notifications, real-time spending insights
- \+ **BaaS providers:** New revenue stream from neobanks that need banking infrastructure without building it themselves

Losers

- – **Traditional banks:** Lose young, digitally active customers to neobanks
- – **Branch staff:** Reduced foot traffic accelerates branch closures

Mixed impact

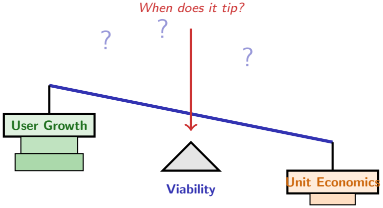
- ∼ **Regulators:** More competition (good) but more entities to supervise (costly) and novel risks to manage
- ∼ **Investors:** High growth potential but long and uncertain path to profitability

Disruption is never neutral – every launch creates winners and losers, and the regulator sits uncomfortably in between.

5 Questions That Reveal a Neobank's True Viability

The Neobank Viability Scorecard
When evaluating any digital-only bank, ask these five questions.

1. **Primary bank or side card?**
   What share of customers use this as their main account?
2. **Licensing ceiling or licensing freedom?**
   Full banking license, e-money, or BaaS partner?
3. **Cost to acquire, cost to keep?**
   Does customer lifetime value exceed acquisition cost?
4. **One product or many?**
   Has it expanded beyond basic accounts into lending or insurance?
5. **Tested in a downturn?**
   Has it operated through a recession with rising defaults?



A neobank that scores well on user growth but poorly on unit economics is a startup, not yet a bank – the five questions separate hype from viability.

Your Challenge: Evaluate a Real Digital-Only Bank

Mini-Challenge (15 minutes)

Choose **one** digital-only bank that operates in Europe. Using publicly available information (website, press releases, annual reports if available), apply the **Neobank Viability Scorecard** from the previous slide.

Your deliverable: A one-page assessment answering each of the five questions:

1. **Primary bank or side card?** Look for clues: does the neobank report "primary account" metrics? What does the product mix suggest?
2. **Licensing ceiling or freedom?** Check: does it hold a full banking license, an e-money license, or does it rely on a BaaS partner? Which jurisdiction?
3. **CAC vs. LTV:** Look for reported customer acquisition costs, revenue per user, or subscriber/premium conversion rates.
4. **One product or many?** List the products offered. How broad is the suite compared to a traditional bank?
5. **Tested in a downturn?** Has this neobank operated through a recession? If not, what risks would a downturn expose?

Conclude with a one-sentence verdict: Is this neobank on a path to standalone viability, or does it need to be acquired, pivot, or raise more capital?

The best way to understand a business model is to stress-test it yourself – apply the framework, form a judgment, and defend it.