

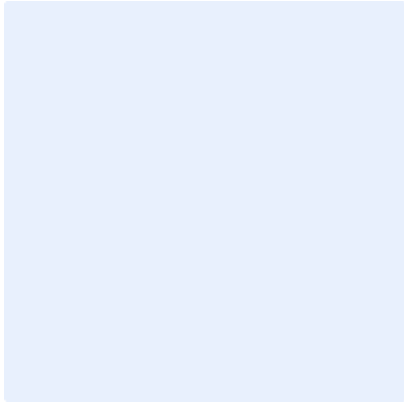


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Neobanks seeking profitability





Neobanks seeking profitability

Study carried out by the Research and risk analysis Directorate and the FinTech Unit of the *Autorité de Contrôle Prudentiel et de Résolution*¹

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GENERAL OVERVIEW

This study follows a first publication by the Autorité de contrôle prudentiel et de résolution in 2018 that was dedicated to the emergence of neobanks². In particular, it aims at specifying the business models associated with neobanks and focuses on two key aspects: the first one is initial contact with customers, in a context within which the regulatory differences induced by national transpositions of European directives on the stakeholders of this sector which could introduce distortions of competition between national and foreign stakeholders. The second key aspect is profitability: neobanks are often represented as liable to shake up the banking landscape. However, several years after their creation, they still struggle to generate profit margins.

In this study, “neobank” refers to all financial stakeholders and intermediaries that offer online banking services or banking services accessible through mobile-only applications. These financial actors are driven by technological progress and by the use of emerging digital technologies. While entry to the banking market is especially difficult due to the competitive edge held by traditional banks, which were able to draw on their experience and reputation to build customer loyalty, these new stakeholders have succeeded in establishing themselves in the market in a lasting manner, sometimes achieving spectacular growth in terms of customer numbers.

Neobanks are characterised by a wide range of business models and offer varied services and product ranges. In order to sharpen their focus and carry out the analysis of the determinants of their profitability in a more detailed manner, in the summer of 2019 the ACPR carried out a new survey on a sample of fifteen neobanks, most of which had already taken part in the previous study: Boursorama (Société Générale Group), EKO (Crédit Agricole Group), Hello Bank (BNP Paribas Group), ING Direct (ING Group), Monabanq (CM11-CIC Group), Orange Bank (Orange Group), Ma French Bank (La Banque Postale Group), Carrefour Banque, DITTO (launched by Travelex, this neobank ceased all activities in February 2020), Nickel (BNP Paribas Group), Qonto, N26, Treezor (Société Générale), Fortunéo (Crédit Mutuel Arkéa Group)³.

This survey was then complemented, during the second half of 2019, by bilateral discussions with some of these institutions. Emphasis was especially given to the issue of profitability, which is strongly linked to acquiring and retaining active customers. Initial contact with customers was another focal point.

As can be seen from the list above, most of these neobanks directly rely on the traditional banking sector, either since the latter acquired them a few months after their creation, or because they were directly created by stakeholders of the traditional banking sector, sometimes in order to counter the emergence of new competitors (see annex 1 on the nature of links between traditional banks and neobanks). Such dependence on the traditional banking sector has a strong structuring impact, both on the determinants of profitability and on the product offer (see annex 2).

In terms of business model, this study identifies four large neobank families. Two of them are relatively old, whether it be online banks usually either developed or bought by traditional banks or distributor banks the banking services of which relies on a non-banking, physical network. Two of them are comparatively more recent, rapidly growing, and comprise on the one hand “mobile pure play” which correspond to banking services offers that are exclusively designed for smartphones, and, on the other,

² See BEAUDEMOULIN N., BIENVENU P. and FLICHE O. (2018), “*Études sur les modèles d'affaires des banques en ligne et des néobanques*” (Study on the business models of online banks and neobanks), Analyses et Synthèses, Autorité de contrôle prudentiel et de résolution, No 95, October.

³ Additionally, some institutions contacted by the ACPR, such as Revolut, BforBank and Manager.one, did not respond to the ACPR's invitations and survey.

customisable banking services offered by Fintechs, prefiguring financial services offers on digital platforms. The latter are usually specialised in payment services, whereas online banks offer a particularly wide range of financial products and services. Among these new stakeholders, the emergence of niche strategies can be observed that are notably designed for VSEs and SMEs.

Regarding initial customer contact, the removal of the systematic check of a customer's place of residence prior to opening an account has been accompanied by the use of new remote identity verification tools ensuring the maintenance of a high level of security. This development could allow French banks to facilitate the remote initial contact with customers and to erase competitive distortions formerly observed within the country.

Two key points emerged from the analysis of neobank profitability:

- First, neobanks are struggling to achieve profitability and to date most of the surveyed institutions have not been able to generate positive net results yet. This situation especially applies to institutions that subsidise new customers, either by granting an entry premium when opening an online account, or by paying a contribution when existing customers sponsor new ones. The main factors underlying the difficulty to generate profitability are significant investments to develop an IT infrastructure integrating the most recent technological innovations and ensuring their operational robustness, including against fraud or cyberattacks, as well as customer base growth projections that are occasionally very optimistic. However, the new, more agile stakeholders seem to either succeed or come close to succeeding. The latter are mainly funded by means of significant fundraising campaigns that may lead to high valuations of customers that are sometimes disproportionate to the net per capita revenue generated.
- However, a gradual improvement of profitability over time can be observed, along with a decrease in the dispersion of results between neobanks, which is undoubtedly related to the gradual amortisation of substantial initial investments. One of the most important issues these neobanks still face is the need to acquire and retain active customers.

This study concludes with the provision of a perspective of some characteristics of the French banking landscape (network of banking agencies that is still very intricate, importance of the role of banking advisor, lack of a real financial services platform) in light of new customer practices. This study was carried out before the Covid-19 health crisis, and despite the associated increase in the use of online services it is much too early to ascertain whether the latter will have a lasting impact on customer behaviour, or on market structures.

Finally, in terms of methodology, it should be noted that this study relies on the collection of *ad hoc* statistical data, and it is unfortunate that, for a majority of surveyed institutions, the aforementioned data is of substandard quality. This may be surprising from digital stakeholders since the mastery of data and customer knowledge form key elements for both strategic development and profitability. However, given the fact that this exercise was carried out on a voluntary basis, the strategic dimension of the required data and the institutional organisation and risk governance within some of these institutions may provide an explanation as to the situation. Additionally, some institutions contacted by the Authority did not respond. In either cases, an improvement of the quality of information is paramount both for customer protection reasons and with a view to financial stability.

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A few key figures of the neobank market

- ❖ **2 million customers were won over in 2019, which represents a 75% increase compared with the previous year**

The number of current accounts opened in neobanks has been multiplied by 2.5% in 2 years, and France counts a little over 3.5 million active accounts. According to KPMG, the incentives for customers are as follows: attractive prices (50% of new customers), an entry premium when opening an account or sponsoring a new customer (34%), and the account opening being immediate (30%)⁴. In order to assess the weight of new banking stakeholders in new account opening numbers, the following should be taken into account:

- (1) Banking mobility: the banking mobility rate has not changed substantially over the recent years. It was estimated at 4.5% in 2014 and now reaches 4.8%, according to the last annual study on banking mobility carried out by the corporate strategy-consulting firm Bain & Company⁵. Traditional banking stakeholders also benefit from banking mobility.
- (2) Customers who open new accounts without closing their former ones:

this second category takes into account the demographic growth and the increased recourse to multibanking. This report takes into account that the French population has increased by 0.3% between 2019 and 2020⁶. Numerous specialists consider that the digital revolution should encourage an increase in the recourse to multibanking. In fact, the figures of Bain & Company rather seem to reflect an opposite trend, since the number of clients holding accounts in more than one bank has gone down, from 40% in 2014 to 31% in 2017⁷, partly in response to the increase in banking costs. Beyond the loyalty of customers to their main bank, this phenomenon could intensify due to the pricing policies of some online banks that charge additional fees if the account is not sufficiently used (for example, by setting a minimum number of payment transactions per month).

4 KPMG study, *panorama des néobanques en France* (the neobanking landscape in France), January 2020.

5 <https://www.bain.com/fr/a-propos-de-bain/media-center/communiqués-de-presse/france/2019/etude-annuelle-bain-company-sur-la-mobilite-et-les-comportements-des-clients-dans-la-banque-de-detail-en-france/>

6 <https://www.insee.fr/fr/statistiques/1892117?sommaire=1912926>

7 <https://www.bain.com/fr/a-propos-de-bain/media-center/communiqués-de-presse/france/2018/etude-annuelle-bain-and-company-sur-la-mobilite-et-les-comportements-des-clients-dans-la-banque-de-detail/>

- ❖ **31% of neobank customers are planning on increasing their use of the services provided**

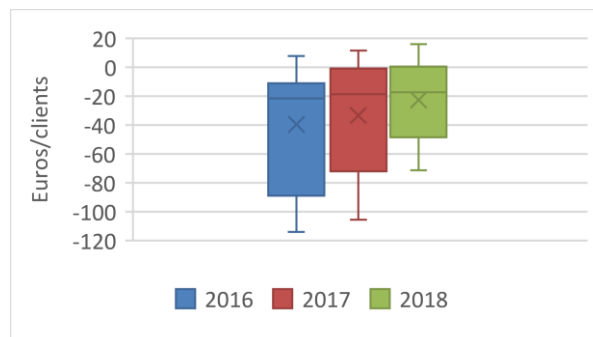
The habits of customers when it comes to neobanks are changing considerably: the diversification of the offer allows established neobanks to change their business model to best meet the needs of their customer base, which in turn incites customers to an increased use of the services provided⁸. This openness could allow neobanks, in due course, to transition from a “secondary bank” status to a “main bank” status. Indeed, according to the study by KPMG 68% of neobank customers state that they would be “ready to use their neobank as their main bank if more banking services were available”.

- ❖ **Neobanks are still either uneconomic or barely profitable**

The net results generated by Neobanks continue to be negative overall after several years of operation, even though a gradual trend towards improvement can be noted along with a narrower dispersion of results over the years.

Only a very limited number of institutions manages to generate profit margins.

Breakdown of net results⁹



- ❖ **Seven new neobanks in 2019 in a market that remains highly concentrated: Paykrom, Pixpay, Xaaly, Holvi, Ma French Bank, Kard.**

The number of neobanks is rising in France, now reaches around thirty stakeholders. However, the market remains highly concentrated. In 2019, the first five “challenger neobanks” or new incumbents according to KPMG’s taxonomy (Nickel, N26, Revolut, Orange Bank, and Lydia) hold close to 78% of the opened accounts in France.

⁸ The current development of neobanks is characterised by a shared approach comprising diversification of the offer and the customer base, internalisation of the stakeholders involved, and pooling of expertise. In view of this dynamic, the abovementioned KPMG study anticipates a transition of the classic neobank model towards a challenger bank model. KPMG also highlights the strong probability that, from 2020 onwards, more than 30 challenger banks will operate at the European level.

⁹ The bars represent the minimum and maximum values, the “box”, the first and third quartiles, the bar inside the “box” represents the median and the cross the mean value.



Neobanks, a heterogeneous assortment of financial stakeholders

The emerging of neobank market structure, which is defined in this study as all the financial institutions offering deposit, payment or credit services, predominantly online, meaning in a different way than the historical retail banking model relying on a physical network of agencies, happened gradually since the development of the internet at the end of the 1990s.

In the previous study carried out by the ACPR on the subject (see Beaudemoulin *et al.*, 2018), four generations of neobanks were identified. The first one comprised all the stakeholders born with the development of the internet (such as ING Direct, Fortunéo, COVEFI or Boursorama), quickly followed by a second generation of offers in reaction to the development of these online banks or seeking complementarity with the physical networks of banking agencies (such as Hello Bank ! or BforBank). The third generation moved away from pure banking, combining an online offer with product distribution and part of the customer relationship relying on a physical non-banking network (such as Nickel or Orange Bank) Finally, the fourth and last generation focused entirely on the payments market, with a solely mobile offering and founded on a sharp decrease of transaction costs and an improvement accessibility to the services provided (N26, Revolut).

In order to detail the outlines and characteristics of these neobanks and assess the ongoing changes in this line of business, the ACPR conducted a new survey with, as participants, about fifteen institutions¹⁰ operating in France during the summer of 2019, followed by bilateral discussions with some of these institutions during the second half of 2019. Emphasis was especially given to the issue of their profitability, which is strongly linked to acquiring and retaining active customers. Initial contact with customers was another focal point, as these stakeholders operate with a wide variety of legal statuses. Some of these statuses are issued by other European authorities in the framework of the free provision of services. When regulatory requirements differ between countries due to the national transposition of European directives, this can lead to some competitive distortions at the expense of national stakeholders.

The answers and exchanges with survey participants show, first, that there are substantial variations in terms of business model, and increasing competition between these neobanks. These business models, which cover a more or less diversified assortment of services (current account, payment, savings or insurance products), can be classified in four main non-exclusive families. Several neobanks included in the study match the characteristics of more than one family.

¹⁰ Boursorama, EKO, Hello Bank, ING, Monabanq, Orange bank, Ma French Bank, Carrefour bank, FITTO, Nickel, Qonto, N26, Treezor, Fortunéo.

1. Neobanks or online offerings

Initially created to capitalise on the development of internet in certain niche markets¹¹, such as online brokerage (Fortuneo in 2000, Boursorama in 2002) or the savings sector (ING Direct offered, as early as 2000, an “Orange” savings account complemented by a life insurance contract in 2004), these neobanks provide their customers with reduced costs compared with traditional banks for basic banking services. Beyond the advantages related to the internet (ease of use, constant accessibility), these stakeholders gave savers access to a wider range of financial products than those available in traditional networks (such as the possibility to operate with foreign exchanges, to invest in investment fund units or in structured products etc.) while offering very attractive rates for their high-income customers. Even today, these stakeholders hold, within their customer base, a significant share of affluent customers, that are mostly urban and especially active in the management of their financial assets. These neobanks only provided their customers with the opportunity to open a current account as a second step, which brought them closer to the online offerings of traditional banks (in 2006 for Boursorama, 2009 for Fortuneo and ING Direct). All these stakeholders have gradually been acquired by major banking groups.

Online banks aim to acquire a broad client base in order to generate network effects and thus reduce, through economies of scale, their overhead costs. In order to acquire new customers, 100% online banks usually offer a significant premium or grant at entry, usually several, either equivalent to a year of banking fees or to the yearly cost of a credit card.

These online offerings allow customers an access to the main financial products and services, often with reduced costs and an easier initial contact compared to the account opening process with a physical banking branch. These banks are attached to banking groups right from their inception (such as ING Direct) or following their acquisition by a banking group (Boursorama by Société Générale in 2002, Fortuneo by Arkéa in 2006, Monabanq in 2008 by Crédit Mutuel at the same time as the purchase of Cofidis), these banks develop a brand catalogue according to two distinct strategies:

- The full distribution of financial services and products offered in agencies (such as Hello Bank ! which is the commercial brand of the French retail banking business line of BNP Paribas);
- The development of a specialised autonomous offering (eg.: BforBank for asset management in 2009) or a generalist offering (Fortuneo).

Limited at first, the use of online banks gradually increased. On the supply side, banking groups saw an opportunity to retain their more digital-minded customers but also to acquire a complementary customer base in addition to that of their main networks. These online banks have also become experimental and innovation centres. For illustrative purposes, the last significant online bank, Ma French Bank, a subsidiary of La Banque Postale, proposes simplified fixed-rate banking services offers supplemented by some features of payment stakeholders (online pool solutions), without income test and relying on a physical distribution network (post

¹¹ Excluding the former COFEVI Bank, former subsidiary of the distance-selling group 3 Suisses International, renamed Monabanq in 2006, which offered as soon as 1997 a current account along with its loss leader, consumer credit.

Offices) to acquire a wider range of customers. This bank has exceeded the threshold of 100 000 customers as early as its first year of operation. This offering is sometimes described as “phygital” (a combination of a physical network and a digital offering), like Nickel, which relies on a network of tobacconists, or C’Zam, the offer of which is sold as a freely available box set in the stores of the large retail chain Carrefour. For illustrative purposes, close to 70% of the account openings at Orange Bank are carried out in sales agencies.

2. Distributor banks (“phygital”)

They rely on the creation of a financial activity that is complementary to the original banking activity of a non-banking group. The initial objective of the distributor banks was to improve the profitability of the group's core business (e.g., C 'Zam for Carrefour group, before the decision taken in May 2020 to discontinue business activity on 15 July 2020), to diversify income or to offer an exhaustive financial offering (e.g. AXA Bank). These entities aim at providing banking services for the group's customers, which allows these entities to enter the banking market without initially entering into direct competition with traditional banking stakeholders and mobile pure players. The reliance on a pre-existing physical network also allows for a reduction of customer acquisition and distribution costs.

The biggest challenge for these stakeholders is the link with the group's original business activity. Some neobanks have adopted a group empowerment strategy to gain a full-fledged banking status in the eyes of their customers. For example, some stakeholders, after attempting to become a retail bank, have been forced to focus on consumer credit for the purchase of products marketed in their chain (for example Carrefour Banque).

Conversely, some players such as Orange Bank (since 2017) extend their customer base (Groupama/Gan customer network starting in October 2018) to build on synergies with their historical activity: cash-back on Orange purchases made with a premium card, credits allocated with the purchase of mobile terminals or invoice reduction for new Orange customers.

3. “Mobile pure play” neobanks

These new entrants are specialised in online payments. They are characterised by a 100% mobile interface and a lack of physical agencies. The proposed offerings are an optimised remote customer itinerary (account opening process carried out in minutes) and a loss leader offer that is usually “freemium”, meaning free of charge for basic services and fee-based for top-of-the-range (premium) services giving access to an online account and a payment card. They are based on a state of the art IT infrastructure where the database construction and exploitation of customer data allows for more agility than traditional banking institutions, which sometimes rely on older and more complex IT systems. The IT infrastructure itself can be outsourced: thus, N26 outsources part of the processing of its core banking business.

The two major players in this market, N26 (a German credit institution established in France since 2017 with a million French customers) and Revolut (English e-money institution established in France since 2015 and with more than 6 million customers worldwide, including 550,000 French customers¹²) have gained significant popularity in recent years. They record a faster increase of their customer base than their direct competitors for basic banking services (current account, payment).

¹² Data published by Revolut and N26 for September 2019.

These “mobile pure play” neobanks finance their growth by raising funds, leading to a significant customer valuation (N26, which has 3.5 million customers in Europe, is valued at EUR 1000 per client as at July 2019), without their long-term strategy (buyback of infrastructure and customer base or organic growth) being affected.

These stakeholders were able to develop their business in Europe using the European passport, before more recently targeting international customers, in particular the US. Their customer acquisition strategy relies on marketing expenses focused on media and social media, and also relies on sharing a customer experience that is deemed to be better than that of other online banks: ease of use and attractive pricing policy (unconditionally free of charge). Therefore, these stakeholders have not developed account-opening offers with premiums or grants. As a result, the cost of customer acquisition, estimated at a few dozen euros, is reduced and does not affect their profitability, unlike online banks opting for a customer subsidy strategy.

4. “Ready to use” or “modular” banks: from “Payment as a service (PaaS) to “Bank as a service (BaaS)”

In this field, the emergence of neobanks occurred in two stages. First of all, the two directives on payment services (PSD1 and PSD2) have allowed for the emergence of new stakeholders who do not necessarily hold a banking licence but who offer services related to payments using an agent model (licence export model).

Such agents shall rely on an institution holding a credit, payment or e-money institution licence that offers new white label services¹³. The business model is therefore built on

a “B2B2C” (business to business to client) model, unlike other models where the interaction with the client is immediate (B2C). The most emblematic example in France is Lydia: launched in 2013, by mid-2018 it had more than 2 million users of its payment services in France without directly holding a licence. As an agent of the electronic money institution “SFPMEI” and of “Budget Insight”, Lydia was able to outsource the operation and liability for the regulated component of its activity, and has been able to grow while benefiting from economies of scale.

It is from this model that new forms of banking organisations have emerged, which could be described as “ready-made” or “modular” banks. These entities generally began their activity as Payment-as-a-Service (PaaS) before becoming Bank-as-a-Service institutions. The United Kingdom pioneered this business model with Bankable (a credit institution created in 2010), followed later by Continental European Fintechs such as Solaris Bank in Germany (created in 2015 as a subsidiary of Finleap, and licensed as a credit institution in 2016) or Treezor in France (created in 2016 with an e-money institution status). Using Application Programming Interfaces or APIs, these Fintechs act as both producers and distributors of banking products and services. They are also operators that provide a technological service enabling new entrants to offer new payment solutions or launch banks in a short period, such as core banking activities and certain compliance services (anti-money laundering and anti-terrorist financing - LCB-FT - Know Your Customer - KYC).

¹³ A white-label service is a service designed by a company that other companies (called “distributors”) take over and market under their own brand name.

These Fintechs thus enable new players to benefit from a reduced cost of entry into the payments market (technical solutions without the need for an ACPR agreement) or the banking services market, thus promoting the diversification of the payments offer and the inclusion of new audiences, such as the provision of banking services for fragile customers, for example.



Customer relationship building: a key element of competition and profitability

1. The remote nature of initial contact with customers is an important differentiating factor

With the exception of certain specific business models, such as Nickel, for example, which relies on the network of tobacconists for the account-opening process, almost all neobanks offer exclusively remote initial contact.

Within the European Union, each country has developed its own national framework for remote identity verification, giving rise to a landscape of heterogeneous frameworks. Some neobanks present in France operate with an approval granted to them by another country of the European Union. For example, N26 holds a credit institution licence in Germany and Revolut, an e-money licence issued in the United Kingdom and an e-money and credit institution licence issued in Lithuania. These different requirements in terms of remote identity verification may result in a customer experience that may create competitive distortions between institutions depending on their geographical point of origin and the nature of their authorisation. Online banks or

neobanks with an agreement obtained in France highlight this difference in the regulatory framework which, according to them, could lead to a sometimes high drop-out rate as soon as they enter into a relationship with the customer.

The verification of the customer's identity when entering into a remote business relationship is indeed governed by regulations, which set the associated terms and conditions. In this context, most of the institutions that took part in the study required their customers to provide two separate documents as proofs of identity and a first transfer carried out from an account opened with a European financial institution in the customer's name. These requirements could keep out some potential clients (first-time entrants or financially fragile people). Electronic signature, despite being subject to internal developments, remained rarely used.

However, this legal framework was extensively revised with the transposition of the 5th "anti-money laundering" directive. The amendments made to these provisions mostly came as the result of the work of the ACPR-AMF Fintech Forum working group on the remote identity verification of natural persons¹⁴.

¹⁴ https://acpr.banque-france.fr/sites/default/files/medias/documents/20190919_synthese_verification_identite_distance_personnes_physiques.pdf

The main changes relate to the following aspects:

- The possibility for financial institutions to use an electronic identification process of a substantial level (corresponding to a level of security equivalent to that observed when entering into a business relationship in a physical branch), without having to implement any other additional vigilance measure.
- greater flexibility with regard to the so-called "complementary" remote identity verification measures to enable financial institutions to use a wider range of technical solutions¹⁵.
- The removal of the systematic requirement to verify the customer's place of residence prior to opening an account¹⁶, which was a constraint impairing the fluidity of entry into a business relationship. A proof of address remains an element liable to be collected, according to a risk-based approach, in order to meet the anti-money laundering and anti-terrorist financing (AML/CFT) requirements of financial institutions.

These changes have led French banks, like their counterparts in other Member States, to implement new remote identity verification tools that make it possible to maintain a high level of security

while making remote entry into a business relationship more fluid and alleviating the previous competitive distortions.

2. A dematerialised customer relationship sometimes supplemented by interactions in physical agencies

For most neobanks, almost all customer interactions are done remotely (web, mobile application, remote customer service) and without a dedicated customer advisor. However, some operations can be carried out face-to-face. Thus, the process of entering into a business relationship, which is both strategic for the growth of the business and a source of operational risks (document and identity fraud), can be carried out at the point of sale, particularly for those whose characteristics correspond to those of distributor banks. A customer can therefore open an account in a store for Orange Bank, in a post office for Ma French Bank or at a tobacconist shop for the Nickel network.

Some specific services can also be carried out in physical locations: additional operations (cash deposits and withdrawals, issuance of bank account details or card replacement) at tobacconist shops that are Nickel agents, deposits of bank cheques and cash in BNP branches for Hello Bank! or in CIC branches for Monabanq customers. Finally, cross-selling is a possibility, especially for distributor banks that offer financial products, most often linked to their non-banking activity (e.g. consumer credit applications in Carrefour Banque agencies for C-Zam customers).

¹⁵ In particular, the removal of the requirement for a second proof of identity, as well as the creation of a new complementary vigilance measure replacing the digital identity check of a substantial level within the meaning of EU Regulation No 910/214, also known as "eIDAS".

¹⁶ Laid down in article R. 312-2 of the French monetary and financial Code.

Generally speaking, the stakeholders surveyed in this study outline the interactions with their customers as follows:

- Interactions through their web interface, while still predominant for initial contact, is being challenged by mobile applications, in particular as a result of the entry of mobile "pure play" stakeholders into the market. It is also still preferred for the subscription of complementary products and complex operations such as stock market orders;
- The mobile application is widely preferred for daily operations, payments and for consulting the online space;
- Finally, for one-time information needs and in case of difficulties, customers contact customer service, by order of preference, by telephone, e-mail and finally through the online chat.

3. Accessible and inexpensive offers coupled with a diversification of the offer

Online banks, such as Boursorama or Fortunéo, initially structured their offering around savings products such as savings books and life insurance products in order to attract affluent and urban customers. However, for these online banks, as for the majority of new entrants, priority is given to accessible entry offers focused on retail banking and payments (free payment card, low or no account maintenance fees). However, the current account coupled with a payment card, which is sometimes associated with loyalty and insurance schemes, is the main loss leader and loyalty-inducing product for new banking stakeholders. Most online banks and neobanks have in place

a pricing model combining free day-to-day services (bank card, no account maintenance fees) with paying services. Two categories should be distinguished: specific pay-per-use services (e.g. overdraft authorisation, payments outside of the Euro zone, stock market orders, etc.) and services accessible via a Premium subscription¹⁷.

In terms of the diversification of the product offering, the situation is more contrasted. Online banks, either created or acquired by traditional banks, offer a wide range of credit and insurance products and services. The housing loans offer, which is one of the main banking mobility factors, is under development in several of them. On the other hand, despite the expansion of the product range, the catalogue remains less extensive and certain specific needs are not covered (e.g. tax exemption, off-plan buying, bridging loans, etc.). The "mobile pure player" stakeholders, on the other hand, have offerings characterised by their simplicity, limited to payment services, account management and foreign exchange, sometimes coupled with consumer credit. From a medium/long-term perspective, neobanks opting for a multi-equipment strategy seek to gradually cover the vast majority of financial needs in order to improve GNP per customer, while the concentration of "mobile pure play" stakeholders does not seem to significantly broaden their product range, except for some transactions in digital currencies (see annex).

With the exception of certain savings products, such as life insurance and investment funds (UCITS), which were their historical core business, online banks offer their customers products from the banking group they are attached to. In fact, the increased recourse to platforms, which would have given these stakeholders with a large customer base (e.g. more than 2 million customers for Boursorama) a customer experience close to that of a market place, is not

¹⁷ "Freemium" model.

observed. Nor is it the case for "mobile pure play" stakeholders, due to the lack of diversification of their product range. On the contrary, the strategies of autonomy in the design and structuring of the products

prevail: the majority of the "new" neobanks in this study expressed their willingness to develop internally the expansion of their product range.



The slow-moving march towards profitability

While the emergence of neobanks could be seen as heralding major upheavals in the banking and financial sector, their difficulty in generating positive net results since their creation may, on the contrary, raise questions about their viability. This difficulty can be partly explained by the difficulty of winning over new customers, which is paramount in order to compensate for the sometimes very significant initial investments devoted to the development and protection of information systems.

However, the analysis of the results of the survey conducted in the summer of 2019 proved to be delicate, given the relatively poor quality of the data, the incomplete nature of the submissions, and even the lack of response from some of the institutions solicited. The poor quality of the submissions made by numerous institutions is

relatively surprising for players operating in the field of digital finance, in which the exploitation of data is central to the expansion of activities and where data should be easy to analyse and exploit.

In some cases, the explanation lies in the difficulty of extracting consolidated or centrally processed information, especially for neobanks belonging to large banking groups.

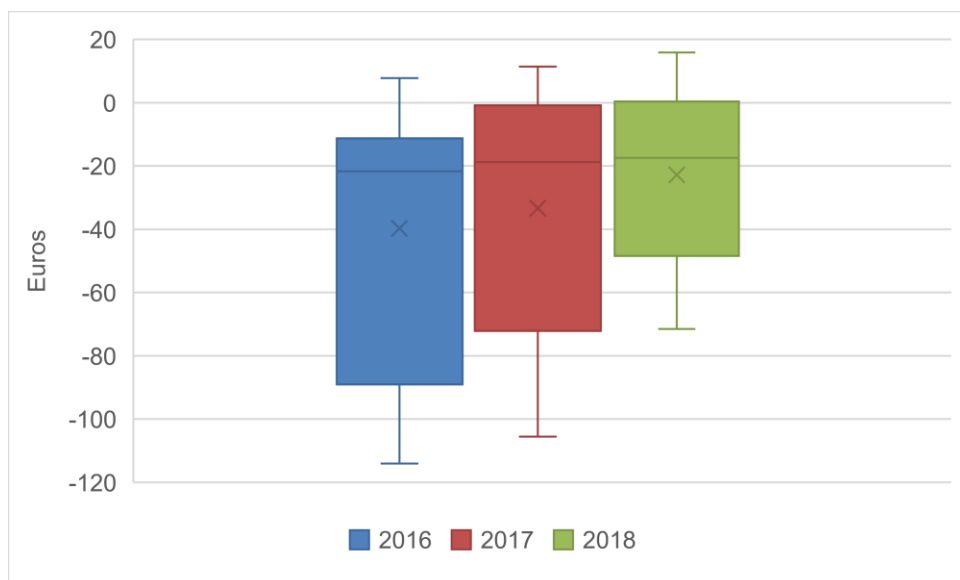
Nor can it be ruled out that the poor quality of submissions is explained by the strategic nature of the data collected by these neobanks and the fact that the ACPR's approach is based on the principle of proportionality, with institutions being exempted from a number of regulatory reporting requirements.

1. Neobanks are usually not profitable over a short-term horizon.

The net results observed for a dozen neobanks operating in France appear negative overall, several consecutive years after their creation. However, a slight trend towards improvement can be observed, as well as less dispersion in the net results within our sample over the recent period (see Chart 1).

Thus, with one or two exceptions, the net results are in negative territory, particularly for neobanks that had expected an overly optimistic increase in their customer base numbers. On average, there has been a significant increase in net income over the last three years.

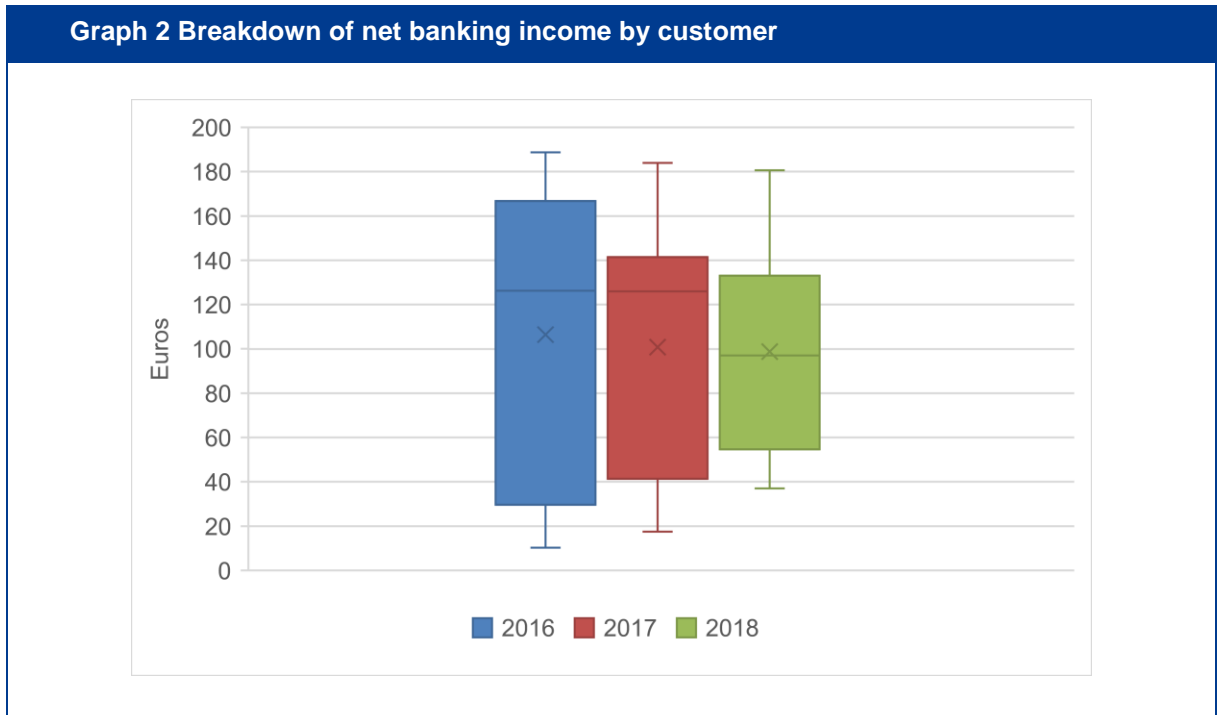
Graph 1 Breakdown of net results by client¹⁸



¹⁸ The bars located at both extremities of the “box” represent the minimum and maximum values, the “box”, the first and third quartiles, the bar inside the “box” represents the median and the cross the mean value..

Over the same period, net banking income, which is increasing in absolute terms, stagnated or even decreased when compared to the number of customers. Thus, the NBI per customer is about EUR 99 on average in 2018 after reaching EUR 106 in 2016 and EUR 101 in 2017 (see Chart 2).

The improvement in the net result is therefore mainly due to a decrease in costs, as some neobanks have amortised the significant initial investments, and to the increase in the number of customers.



This low profitability can be explained by the diversity of the strategies deployed by the stakeholders. We also encountered:

- Defensive strategies that notably emanate from the neobanks that are subsidiaries of traditional banks: their objective is not so much direct profitability as adapting to the more aggressive or innovative offers of their competitors, in particular the new purely digital players, in order to retain their clientele.

In this case, profitability must be assessed in the light of the banking group's overall strategy and take into

account the internal pricing of its activities. Examples of this type of strategy can be found in the offers recently proposed by Fortunéo ("Fosfo" offer), Boursorama ("Ultim" offer) or ING ("*Essentielle*" offer), the aim of which seems to be above all to directly compete with the offers of the latest generation of neobanks. Thus, like the latter, Euro and foreign currency withdrawals and payments are offered free of charge, mobile payments are integrated but, unlike the latter, overdrafts are sometimes authorised.

- Start-up strategies are adopted by newcomers to the market, particularly Fintechs. Their main objective is to offer innovative products and to show rapid growth in turnover or customer base numbers in the hope of being bought out quickly by an existing bank, regardless of a real concern for profitability in the very short term. It should also be noted that purely digital offers can succeed in limiting their costs sufficiently to break even with a relatively small number of active customers, which makes them even more attractive.
- Finally, the search for network effects: a third strategy, not necessarily incompatible with the second one but carried out with the aim of establishing a long-term presence alongside traditional banks, consists of aggressively proposing a free service offering with the aim of very quickly capturing a large part of the customer base in order to increase, in a second stage, the rates or supplement the basic services with a more elaborate and paying premium offer. In this context, time is of the essence, as failure to achieve the planned customer growth plans overwhelmingly condemns to the cessation of business or to buy-out by another financial institution at a potentially depreciated price.

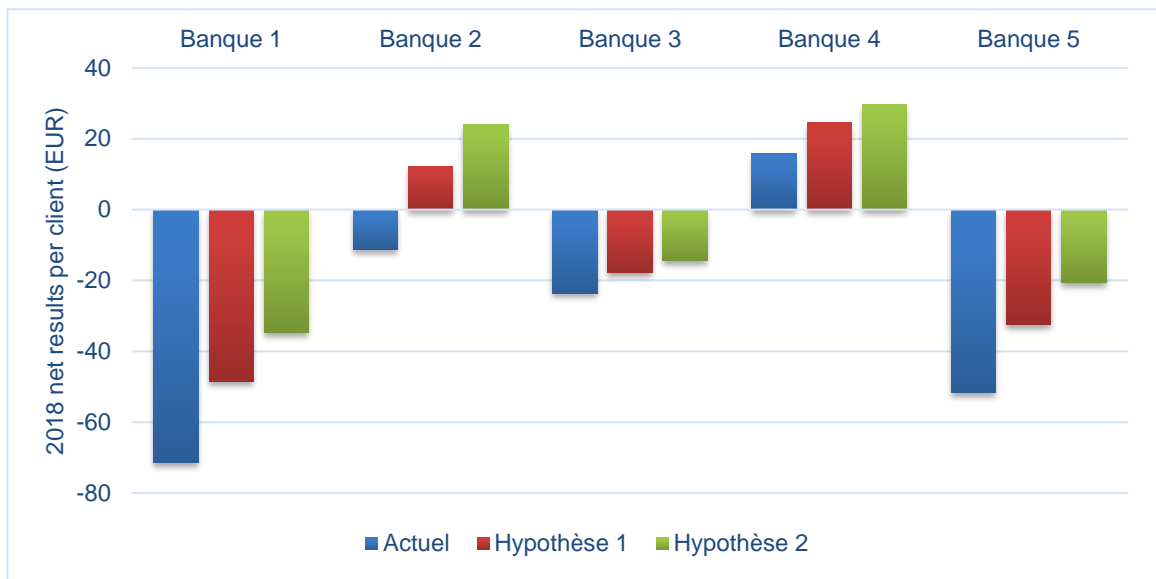
2. What are levers do neobanks have to improve their NBI and profitability?

2.1 The challenge of customer acquisition

In this highly competitive environment, the viability of neobanks crucially depends on their ability to acquire and retain new customers. However, this customer acquisition, whether through a welcome offer or customer experience development, comes at a price.

Thus, for banks offering welcome offers and contributions in the case of customer sponsorship, the cost of acquiring the customer is a significant burden on the net result. Graph 3 below shows the net result for 2018 of five neobanks offering entry premiums when opening an account. To measure the impact of the cost of the contribution on net income per client, a valuation is proposed here based on two different assumptions for the restatement of the contribution: (1) only 25% of new entrants are sponsored and (2) 100% of new entrants are sponsored. It is furthermore assumed that the amount of the entry premium for the new entrant and the sponsor is equal and set at EUR 80.

Graph 3 Analysis of the impact of customer acquisition premiums on net income per customer (2018)



Assumption 1: 2018 net income is restated for all customer acquisition premiums, assuming that 25% of new 2018 customers were sponsored.

Assumption 2: 2018 net income is restated for all customer acquisition premiums, assuming that 100% of new 2018 customers were sponsored.

In both assumptions, the premiums for the new client and his possible sponsor are estimated at 80 euros.

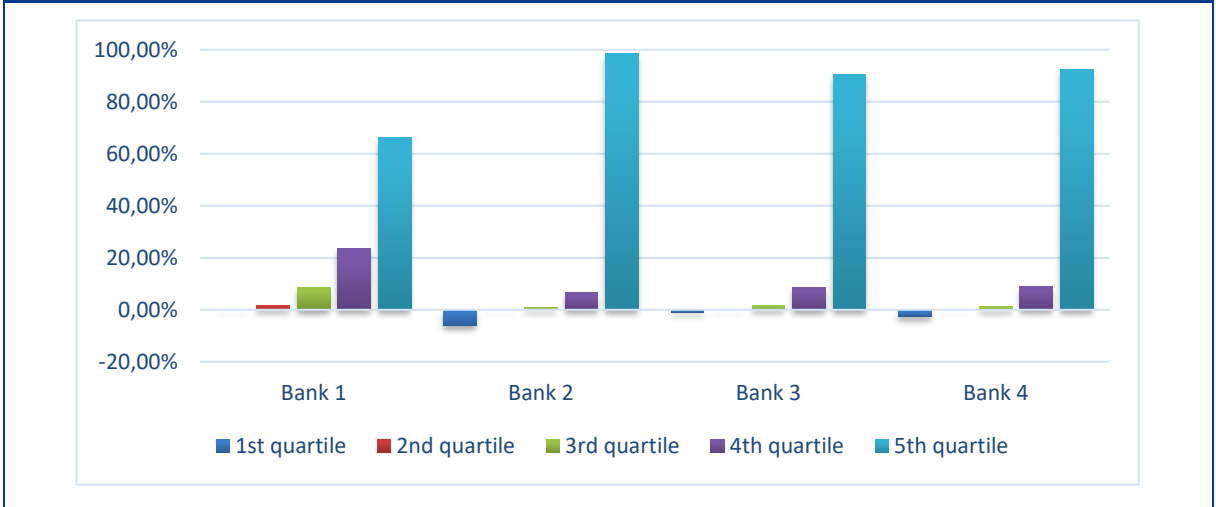
This graph shows different scenarios: first of all, some neobanks (such as Bank 4), for example, although they have reached a customer base large enough to exceed the break-even point, retain attractive offers for the acquisition of new customers. Similarly, potentially profitable banks without the welcome offers (such as Bank 2) continue to offer them despite their negative impact on net income. Maintaining such offers enables them to remain attractive in order to win over new customers in a highly competitive environment but also to retain their own customers, who are very mobile as they are often poorly equipped, in particular by seeking to generate network effects. Finally, some neobanks (such as banks 1, 3 and 5) fail to break even, even after

restatement for the contribution. They therefore find themselves in an unfavourable situation and consequently remain very dependent on the financial support of their parent company.

2.2 The need to turn the customer into an active customer

An analysis of the distribution of the NBI of neobanks by income quintiles of their clientele shows a very targeted composition of the latter: thus, almost all of the NBI is generated by the highest income bracket (the 20% with the highest income; see Chart 4). A breakdown of NBI per decile or percentile, which some neobanks have indicated that they would not be able to provide without *ad hoc* developments, would make it possible to distinguish more precisely the proportion of active customers and its homogeneity.

Graph 4 Breakdown of the NBI of a few neobanks by income quintile of their clientele



Such a concentration of the neobanks' NBI, which is, moreover, low per customer, on such a small proportion of the clientele, demonstrates the importance of making this clientele active, i.e. of inciting it to carry out transactions or operations which are the source of the commissions received.

On this topic, three strategies seem to exist.

On the one hand, that of online banks, subsidiaries of traditional banks, which offer their customers a wide range of products and services, similar to those available in banking agencies, but without account maintenance fees and with bank charges that are often much lower than those borne by customers in physical agencies. In addition, some of them require a minimum number of transactions per month on the account; when this minimum number of transactions is not reached, the neobank may charge a non-use fee of up to EUR 5 per month. In order to limit the risk of adverse selection by customers who want to collect premiums and then leave their accounts inactive, these online banks make the opening of accounts conditional on the payment of a large amount of money, in the range of EUR 200 to 300, from a bank account or a credit card as part of customer identification procedures.

On the other hand, that of the natively mobile-based neobanks, based mainly on the "freemium" model, which relies on free access to an account and the absence of fees on payments and withdrawals abroad, generally coupled with a payable offer that gives access to a wider range of services. They also rely on a more efficient and more recent information system architecture, enabling them to reduce transaction costs and thus offer free services.

Finally, some distributor neobanks, such as Orange Bank, are focusing on developing a so-called "valued" customer base, meaning one that is likely to generate a significant NBI per customer, either by equipping customers with a premium offer or by achieving synergies with the group's historical business.

The poor quality of the data provided by the neobanks that took part in this survey does not allow for a more detailed analysis of the level of customer activity. Furthermore, there is no harmonised definition of the notion of an "active customer", with some stakeholders considering, for example, that this activity is measured by the minimum, albeit reduced, number of transactions per month, while others are satisfied with a monthly automatic transfer to consider the account active.

New customer habits and prospects for the banking sector

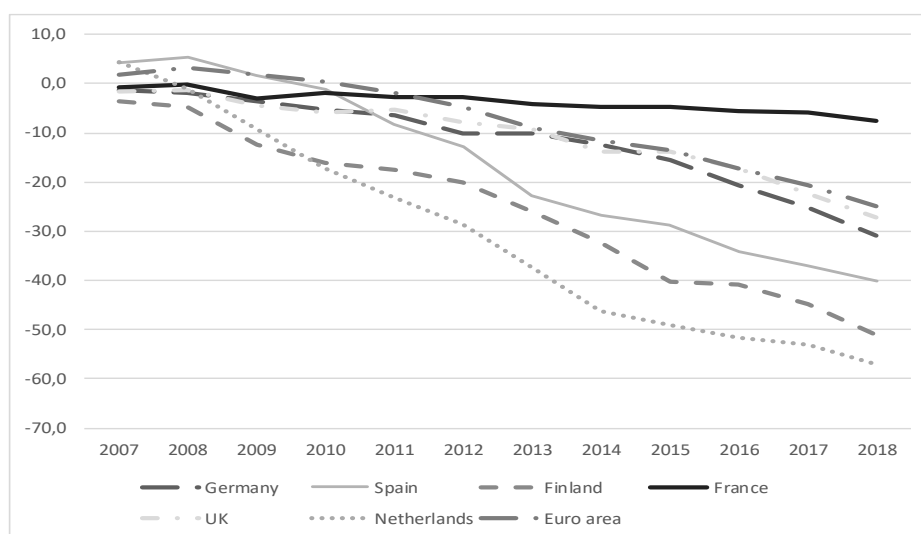
1. The growing importance of the role of trusted third party as a complement to advisory services

The strategic objective of neobanks is to build the broadest and most sustainable customer relationships possible in order to maximise the proportion of profitable customers. With this in mind, they are trying to distinguish themselves, particularly in the case of "mobile pure play" stakeholders, from traditional banks, by developing communication based on ease of use and transparency.

However, the impact of digitalisation and the emergence of neobanks do not, for the time being, seem to have shaken the French financial landscape to the extent that might have been anticipated.

In this respect, France even appears different. Chart 5 below shows the evolution of the number of banking agencies in a number of European countries since the major financial crisis of 2008. Under the combined effect of bank restructurings due to the 2008 financial crisis, the outsourcing of certain activities to platforms abroad and the increasing digitalisation of the sector, the number of bank branches has dropped sharply in a number of European countries, with the number of branches in the Netherlands and Finland falling by almost 60% over the last 10 years. It is close to 40% in Spain and around 25% in the Euro area. This is not the case in France, where the number of agencies has only dropped by 7% over the last decade.

Graph 5 Developments in the number of banking agencies in Europe



Source: European central bank – Statistical Data Warehouse

One explanation may lie in the investment made by traditional banks in improving services and in particular the role of customer advisers in branches. In addition, the relatively low exposure of French banks to the 2008 financial crisis and the wide range of financial products and services offered in branches, particularly through the *bancassurance* model, partly explain this situation. An additional reason is the importance the French attach to their relationship with their banker¹⁹.

In France, therefore, there is a coexistence between, on the one hand, traditional banks, which remain the preferred intermediaries for the financing of the important stages that structure customers' lives, such as acquisition of property (and the underwriting of the associated loan) or taking out of a life insurance policy, and the growing role played by neobanks as everyday life banks, specialising in particular in payment services, on the other hand. This effect is particularly pronounced among younger customers.

Among the new features offered by neobanks, there are digital safe services to store essential documents (identity documents, proof of address, invoices), illustrating the growing confidence that customers place in them.

3. A contribution to banking

The new offers proposed by neobanks allow the generalisation of basic banking services (payment account

without income-testing, card payments or inter-currency transfers) to the entire population. The subscription process for neobank offers is becoming increasingly simple and fluid. It is facilitated by the diversification of the offer, such as the provision of banking services from new institutions established in other European Union countries and the revision of the regulatory framework for remote entry into a business relationship²⁰. Thus, the use of these services no longer requires the loyalty of use that is specific to retail banks with a physical network, resulting in a sometimes-high inactivity rate when the need for use disappears. It is no longer rare for customers to subscribe to an online offer for a temporary need (facilitate a trip or an expatriation, collect money for one-off events, or pay online).

In addition, neobanks make it possible to extend the accessibility of banking services to a part of the population in need of them. Job seekers, the financially precarious, inactive young people: all these originally poorly integrated populations can benefit from more accessible banking products. Income and asset testing are becoming rarer, even for traditional online banks, which rely on savings, investment and insurance products offered to affluent customers for a significant portion of their net banking income. Some stakeholders, such as Nickel, made it their strategy to target these populations directly. The absence of income conditions and the promise to control incident costs are therefore essential attractiveness criteria.

19 See Clerc et al. (2019): "*Les néobanques vont-elles bouleverser leur secteur d'activité ?*" (Will neobanks disrupt their business sector?) *Revue d'économie financière*, No 135, 3rd quarter 2019.

20 The transposition of the 5th LCB-FT Directive resulted in Ordinance No 2020-115 of 12 February 2020 as well as implementing decrees No 2020-118 and No 2020-119 of 12 February 2020 proposing new requirements for remote entries into a business relationship.

Some of the institutions covered by this study are present in several European countries (ING Direct, Hello Bank!, N26, Revolut and Fortuneo²¹), whether that presence be centred around declining a trademark (Hello Bank!) or proposing a virtually uniform service offering at the level of the European Union (N26). The internationalisation of neobanks is not a systematic phenomenon but is fostered by two factors:

- The freedom to provide financial services within the European Union;
- The European regulatory framework on LCB-FT, which allows a neobank to develop only a single remote identity verification system that shall meet the national regulatory requirements of the Member State providing its licence.

Finally, there is also a growing trend towards offer diversification towards corporate banking services. Several neobanks are positioning themselves in the SME/VSE, self-employment and auto-entrepreneur segments, while certain institutions, such as Orange Bank, are continuing to develop the credit business assigned to their historical distribution activity.

4. The lack of platforms dedicated to financial services is another French peculiarity.

The development of platforms²² grouping together financial services makes it possible to offer, on a single dematerialised interface, a set of banking, insurance or financial services. The platform can lower intermediation costs by encouraging competition between providers wishing to offer their financial services on this platform. This market structure tends to favour the side of the market with the highest price elasticity, generally the consumer, hence many free or even subsidised registration offers (e.g. payment of an entry premium). This type of platform is already highly developed in many countries such as the United States, China and in financial centres such as Singapore and Hong Kong. In France, it is usually the banks that offer banking, financial and payment services via their websites or mobile applications. However, there is no real platform providing customers with a comprehensive and differentiated range of financial products or services. The high concentration of activity within a few major banking groups enables them to offer a comprehensive range of products and services

²¹ Fortuneo, which is a brand of Arkéa Direct Bank, is also present in Belgium and Luxembourg via the Keytrade brand.

²²The academic study of platforms has given rise to the theory of "two-sided" markets (see Rochet and Tirole, 2003) where the platform is an intermediary that interposes itself between a side that corresponds to the demand for services or products (consumers) and a side that corresponds to the supply (in this case, financial service providers). It derives its remuneration from the exchanges between these two sides through commissions (cost of entering the platform and transaction fees, even if this means sometimes subsidising one of these sides to maximise its profits). ROCHET J. C. and TIROLE J. (2003), "Platform Competition in Two-Sided Markets", Journal of the European Economic Association, vol. 1, No 4, pp. 990-1029.

developed internally. The strategy observed among neobanks operating in France, whether traditional online banks or mobile "pure play" stakeholders, appears to be similar: increasing the customer base is seen as a priority because it generates NBI through the sale of the group's banking and payment services.

To some extent, the *bancassurance* model that is particularly developed in France may explain the very good resilience of traditional banking networks. Additionally, although some neobanks, such as Fortunéo, Boursorama or BforBank, as well as most online offers (Hello Bank!, Eko), offer a range of insurance products (Life or Fire contracts, Accidents and Miscellaneous Risks), the latter remains scarcely promoted. For these stakeholders, insurance products do not constitute an appealing product and none of the neobanks questioned for this study indicated that they emphasise the synergy between banking and insurance products to their customers.

The rise of platforms could take place in France through two main channels:

- an evolution of the structure of the offer of the French neobanks, choosing to become multiservice platforms, by offering their customers a role as a trusted digital third party as well as a controlled monetisation (General Regulation on Data Protection, 2nd Directive on Payment Systems) of their personal data;
- an entry into the Bigtechs market, which could thus exploit their broad customer base to offer financial services, with the support of Fintechs or financial intermediaries offering their expertise, capital and regulatory licenses via Payment-as-a-Service (PaaS) or Bank-as-a-Service (BaaS) models.



Conclusion

After having long been considered either as being complementary to the offerings of retail banks or banks that specialise in niche markets (brokerage, asset investment), neobanks have now gained in maturity. Their offer has also become more diversified. It gives their customers access to a wider range of financial products and services, with simplified accessibility conditions and reduced costs.

The profitability of neobanks continues to be penalised by the new customer acquisition costs. However, it tends to improve and allows some business models to present projections of

positive net revenues, based on several levers: growth of the customer base, acquisition of active customers and cost control. On the other hand, customer loyalty and the sensitivity of results to network effects remain difficult to assess due to a lack of data.

In addition to the challenge of profitability, these institutions will also have to change their offering to meet the evolving needs of customers and the growing competition from BigTechs, as well as from mobile digital platforms offering, on a single medium, a multiplicity of banking and financial services and products.

Appendixes

1. Links between traditional banks and neobanks

Neobanks	Date of creation/ date of approval	Legal status / personality	Links with traditional banks
Boursorama	1995/1998 approval : 25/07/2003	Credit institution	Subsidiary of Société Générale since 2002
Monabanq	1997/02/10/2006	Credit institution	Subsidiary of Crédit Mutuel since 2008
ING	Approval : ING direct 29/01/2002	Credit institution	Created by ING bank
Fortunéo	Approval : 13/09/2000	Credit institution	Subsidiary of Crédit Mutuel Arkéa since 2006
BforBank	Approval : 22/07/2009	Credit institution	Created by les Caisses régionales du Crédit agricole
Hello Bank	16/05/2013	Offer	Created by BNPP
N26	03/12/2015	Credit institution	German On-line bank
Nickel	11/04/2014	Credit institution	Subsidiary of BNPP since 2017
Revolut	15/07/2015	Credit institution	UK digital bank
Treezor	Approval : 21/06/2016	Electronic money institution	Subsidiary of Société Générale since 2018
Qonto	04/2016	Payment institution	Online banking for companies and the self-employed whose entrusted funds are confined to Crédit Mutuel Arkéa
C-Zam	04/2017	Offer	Offer of Carrefour banque
DITTO	2017 in France	Credit institution	On-line bank from Luxemburg (operating in France since 2017 – Subsidiary of Banque Travelex)
EKO	08/11/2017	Credit institution	Created by Groupe Crédit Agricole
Orange Bank	Approval 04/10/2016	Credit institution	Online banking launched following Orange's entry into Groupama Banque
Enjoy	09/2018		Created by Caisse d'Épargne
Ma French Bank	Approval : 25/01/2018	Credit institution	Created by La Banque Postale

Source: ACPR and public information displayed by the institutions.

2. Range of products offered by neobanks

	Boursorama	EKO	Hello Bank	ING	Monabanq	Orange bank	Ma French Bank	Carrefour banque	DITTO	Nickel	Qonto	N26	Treezor	Revolut
Life insurance	X	X	X	X	X									
Property insurance	X	X	X		X									
Insurance of persons	X	X	X		X									
Discovered	X			X	X	X			X					
Consumer credit	X	X	X	X	X	X								
Home loans	X	X	X	X										
Non-financial products	X	X												
Current account	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Bank card	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Cash withdrawal / deposit		X	X	X	X	X		X	X	X	X	X		X
Check	X	X	X	X	X	X								
Transfer / direct debit	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Account information service	X	X	X	X	X		X							
Payment initiation service	X	X	X				X							
Securities account and PEA	X	X	X	X	X									
Brokerage services	X	X	X											
“Unregulated” bank book	X	X	X	X	X	X								
Regulated booklets (Booklet A, etc.)	X	X	X	X	X									
Mobile payment	X	X	X	X		X	X	X						X

Source: authors, based on information collected from the institutions' websites. Table prepared for the article published in the *Revue d'économie financière*, No 135 - 3rd Quarter 2019. See Clerc et al. (2019).