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Decreased funding and valuations create a 'sink or swim' moment for neobanks

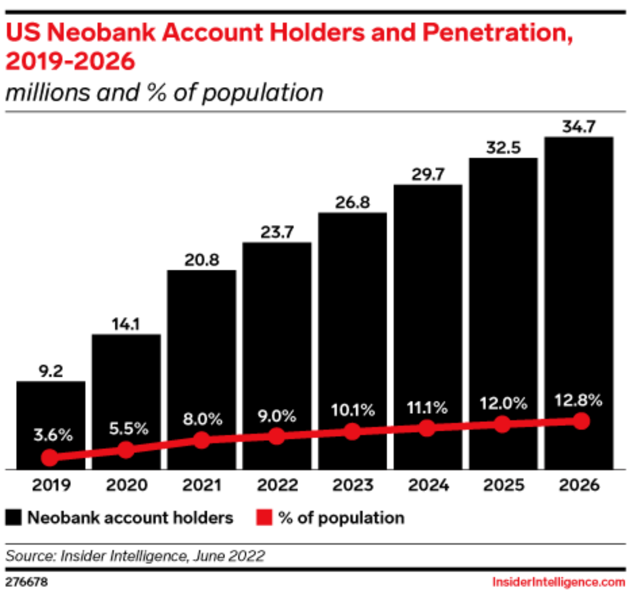
Article

The news: Neobanks need to adjust their short- and long-term strategies to survive in an uncertain economic environment and remain a dominant force in the banking space.

What's happening? After a profusion of large investments in neobanks in 2021, investors are now looking for a return on their investments in the form of sustainable profits.

- But neobanks are struggling to reach profitability, and as funding dries up and valuations drop, they'll need to refine their strategies.
- They will need to move from a customer acquisition mindset to cutting costs and growing profitability. This means pivoting from offering low-cost or no-fee incentives and high yields to creating new revenue-generating offerings.
- Those that do this successfully will come out leaner, more cost-efficient, and in the black.

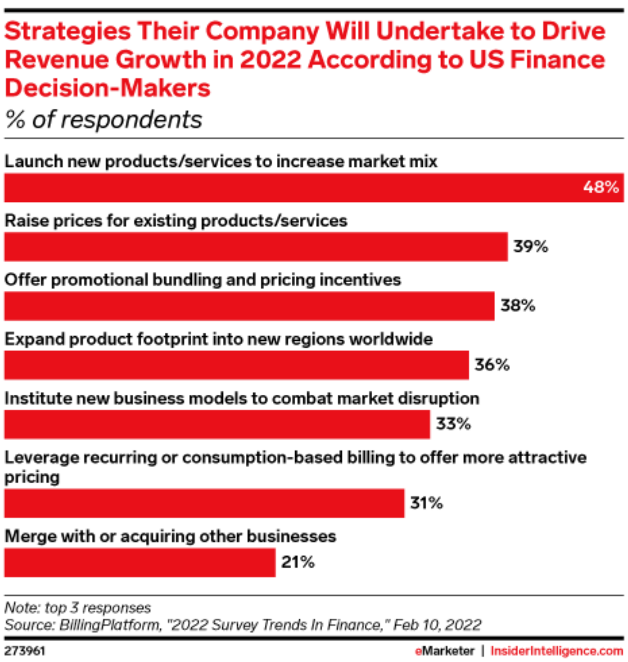
In our report, Neobanks Confront Uncertainty: How Challengers Can Create a Lifeline as Funding Dries Up, we look at what neobanks can do in the short term to stay alive, and highlight some bigger changes on the horizon that could spell trouble for the struggling entities.



Short-term trends: Neobanks must act fast to turn themselves around. Here's what they can start doing in the short term to keep going.

- **Slowing down customer acquisitions by reducing perks and eliminating no-fee products and services** will help cut down on expenses. But it may only be a short-term fix if neobanks can't find new ways to generate revenue from existing customers.

- **Driving up deposits and transactions among existing users will drive up revenues,** as neobanks generate much of their revenue through interchange fees. But they should be cognizant of how they promote such actions. Incentives like a high-yield savings account will increase deposits but will likely also drive up costs.
- **New lending products, such as credit cards and buy now, pay later (BNPL) options will provide an additional source of revenue** for neobanks on top of interchange fees. Offering these types of products might be a more cost-efficient method for increasing income.
- **Neobanks that risk going under in the near future might benefit from seeking a buyer.** Valuations are low, which means that this might be an optimal time for incumbent banks or other financial institutions to enhance their business by scooping up a neobank.



Long-term changes: Neglecting the short-term adjustments will lead to insurmountable long-term changes in the banking space that will make survival impossible.

- Neobanks that have attained profitability will begin **branching out into new areas to offer a subscription-based, super-app-like experience.** They will be able to move into even more profitable sectors like investing, home lending, and small business banking.
- **Neobanks that are still gasping for life will eventually get pushed out by megafintechs and Big Tech.** These firms will step in as primary banking providers as customers abandon failing

neobanks. And it won't be difficult, as these firms already have a wide-spanning hold on customers.

- Even successful neobanks will face challenges. Historically, neobanks have enjoyed relatively lax regulation, but as consumer protection agencies like the CFPB and the FCA beef up their scrutiny, **we expect neobanks will face some new and tougher rules and regulations.**

Go deeper: *To read more about our recommendations on how neobanks can cut their costs, reach profitability, and satisfy their customer base, click here.*