

# Starling's and Varo's diverging paths highlight need for neobanks to prioritize profitability

Article

**The news:** Starling reported its first annual profit after successfully diversifying into the mortgage market and tailoring its strategy to focus on bottom-line growth.

- The neobank [posted](#) a pretax profit of £32.1 million (\$44.1 million), swung from a £13.7 million (\$18.8 million) loss for the same period a year before. Mortgage lending helped boost revenues and reached £1.2 million (\$1.7 million) in Starling's first year of involvement.

Separately, **Varo Bank** laid off around 10% of its workforce and plans to restructure the business in an effort to cut losses.

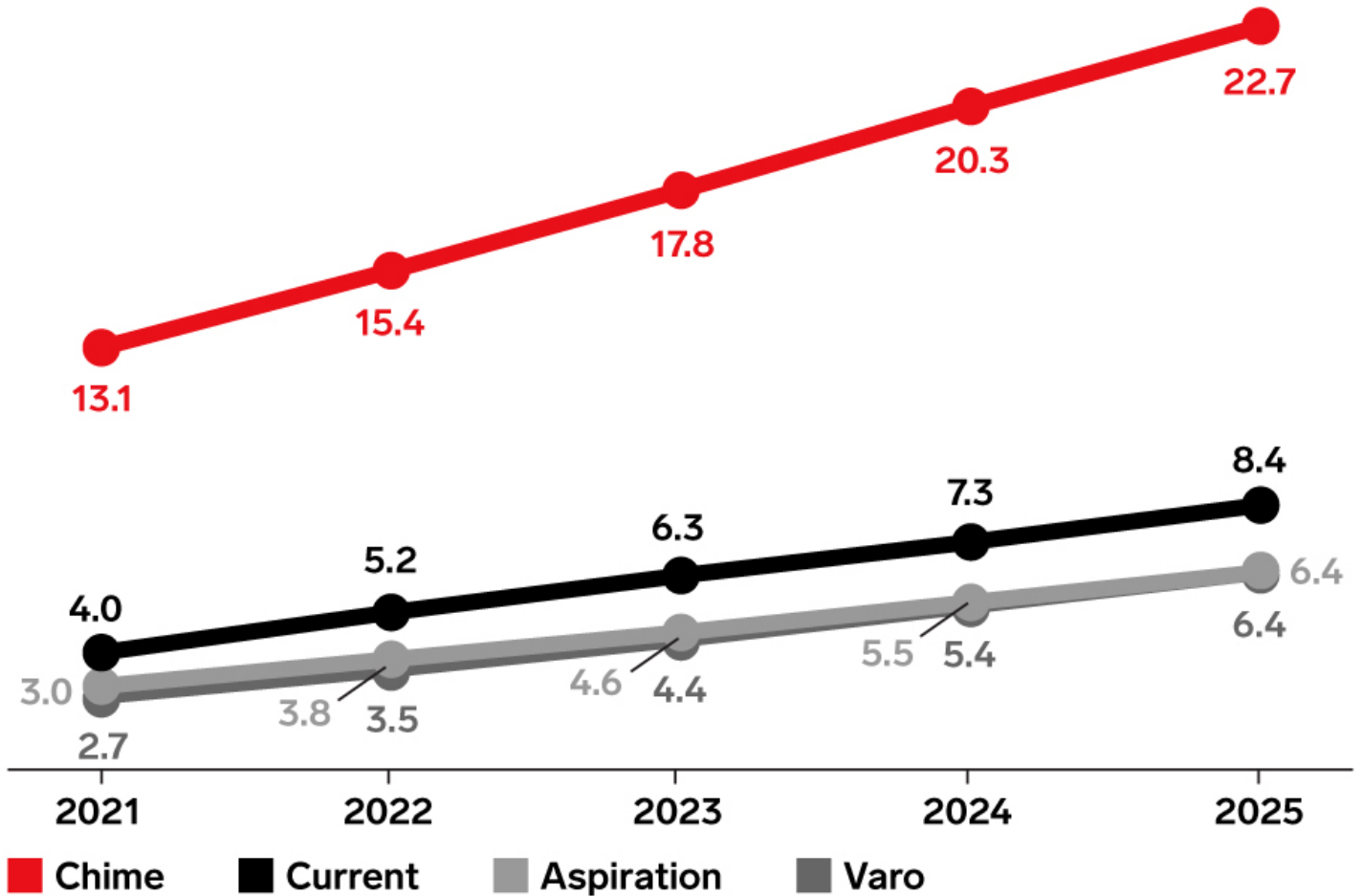
- The US neobank made 75 employees redundant and plans to consolidate its technology, design, data, and product divisions into a new business unit to reduce costs and “increase pace,” according to a [press release](#).

**Bottom-line pressure builds:** Starling will join [Atom](#) within an exclusive group of neobanks that have achieved profitability or are on track to break even. But as Varo's losses show, profitability is notoriously elusive for challenger banks.

- In June, we [reported](#) that Varo risks running out of funding this year and will have to raise cash to stay afloat—which looks increasingly challenging as [fintech funding becomes scarcer](#).
- Many of Varo's problems stem from its inability to turn a profit, despite opening 2.7 million new accounts in 2021.
- That's forcing it to take drastic action to shrink its cost base. In the first quarter, it laid off 65 staff to shore up its bottom line.

# US Neobank Account Holders, by Company, 2021-2025

millions



Note: individuals who hold at least one account at an independent, digitally native, digital-only bank that has either a banking license or operates on a licensed bank's platform (such as Chime or Varo in the US, Monzo in the UK, and Koho in Canada); account holders are not mutually exclusive; there is overlap between groups

Source: Insider Intelligence, May 2021

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**What next?** Neobanks need to pivot their strategies to adapt and focus on generating profits in a harsher-looking H2 2022.

1. **Lower costs:** Varo is finding out the hard way that high overhead costs that exceed revenues aren't sustainable. One problem is that customer acquisition costs have generally risen for neobanks due to incumbents improving their digital offerings, and the market has become more saturated.
2. **Shift to more profitable products:** Focusing on higher-profit products and dropping less lucrative ones will be important as newer entrants' strategies shift away from merely attracting customers. **Starling's [decision](#)** to focus on software as a service (SaaS) and mortgage lending, rather than European expansion, is one example of this kind of pivot.
3. **Expanding features for paid tiers:** Challenger banks can use new features to draw in paying customers. **Monese** has aimed to achieve this through its **[Essential tier](#)**, which charges lower fees for international transfers and foreign exchange conversions.

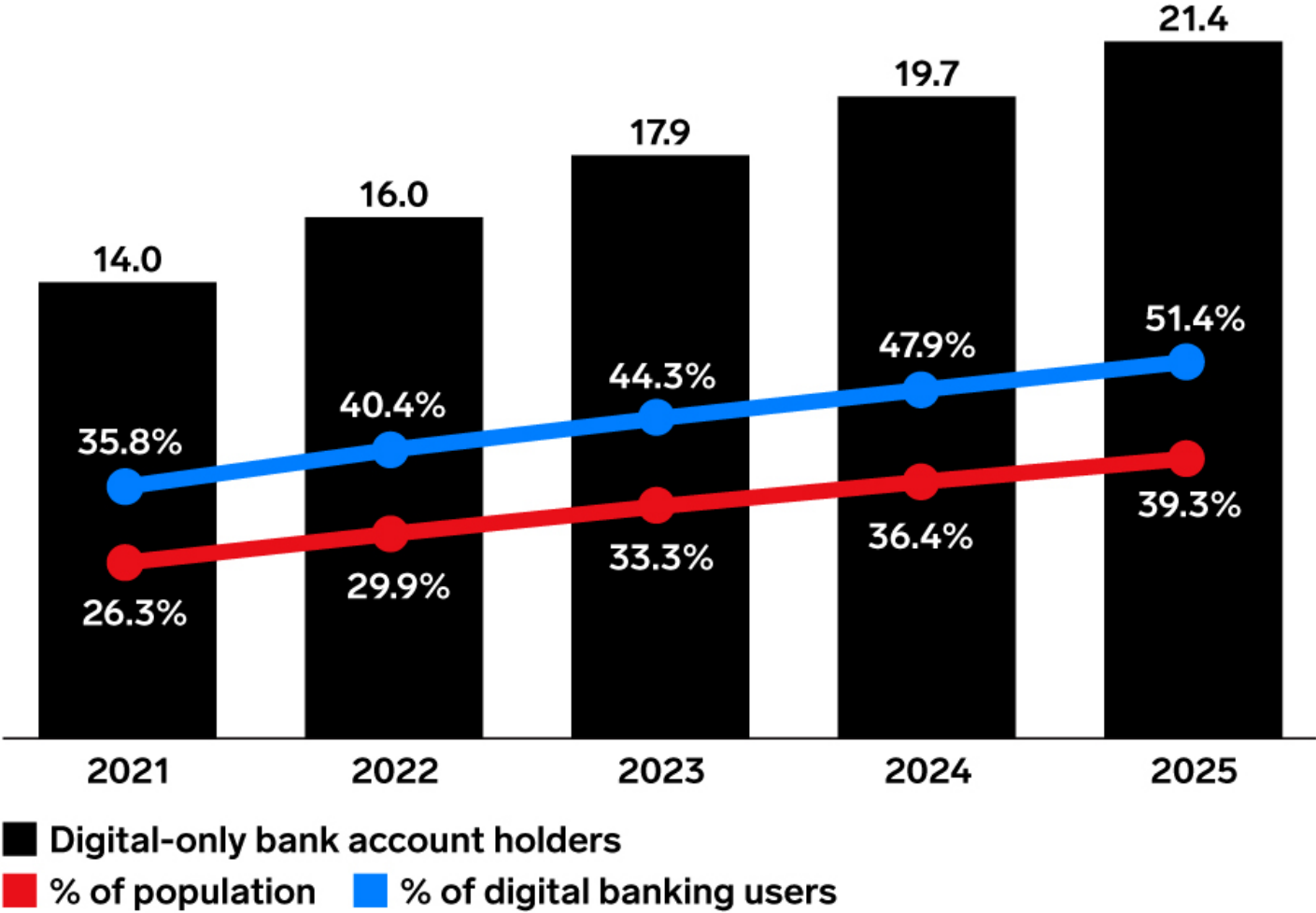
Varo's **[launch](#)** of a new high-yield savings account earlier this month could be risky. The high-interest offering is likely to draw in more users, but may not generate the revenues required to improve the neobank's bottom line.

**The big takeaway:** Neobanks' inability to turn a profit is nothing new, with less than 5% breaking even, **[according](#)** to Simon-Kucher & Partners. A growth-at-all-costs strategy made sense when the market was buoyant, but they now need to adapt and fight to become profitable to ensure their survival, as Starling has successfully done.

The leaner funding climate favors more established companies and increases pressure on far-from-profitable neobanks like Varo, which may lose investors who question their long-term sustainability. If a neobank shakeout occurs in the coming years, the banks that can adapt to remain profitable are the ones that stand to survive.

# UK Digital-Only Bank Account Holders and Penetration, 2021-2025

millions, % of population, and % of digital banking users



Source: Insider Intelligence, May 2021

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