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NEOBANK: BUBBLE OR PARADIGM SHIFT?

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Specific features of contemporary financial and banking markets are studied. Recent appearance of a basically new financial institution called «neobank» and its influence on economic environment worldwide are explored. The reasons causing its appearance, economic, political and social conditions of its formation, and also its influence on the economic environment in the world and specific countries are studied. The main attention is focused on analysis of situation on the Ukrainian neobank market, its presence and prospects.

Keywords: neobank, mobile bank, virtual bank, internet-bank, digital bank, challenger bank, financial system, banking system.

Statement of problem. The term «neobank» refers to the institution that provides some combination of checking accounts, savings accounts and debit cards via

digital channels-primarily mobile-without any physical bank branches[1]. At the same time, there are other words that have the same meaning like «mobile bank», «virtual bank», «inter-

net-bank», «digital bank» or even «challenger bank».

The banking service integration into the virtual spaces had taken place well before the explosion of mobile technology and people's distrust for banks due to financial crises in 2008. It is the First Direct rated as the first neobank worldwide. In 1989 this British challenger was the first that implement the strategy of working without offices, round the clock, and providing the support for clients, in the number of 100,000, by call-centers. Now it is continuing its functioning as a department of HSBC Bank plc.

The Internet technology allows the banking institution to reduce their operating costs. That is why in 1998 the first internet-bank Egg was founded in Great Britain. Its costumers, more than 2 million of people, were provided with the opportunity to control their accounts with the help of call-center and internet-portal.

In the middle of 2000 the advantages of online- and phone-banking has become undeniable. So that the traditional banks had included such kind of services in their main products reducing the number of branches. But it was the 2010s, when the neobanks hit the headlines.

The main difference between the neobank and bank's internet-service is the absence of traditional infrastructure of banking branches. In spite, neobanking could serve as the classic or virtual payment card, mobile deposits, personal transactions, instrument of mobile accounting or digital receipt using phone numbers, e-mails or social networks as the methods of clients' identification. It is common case for neobank to have high interest rates or charge the minimal up-front fee because of low level of operating costs, for example average British bank spend 50% of total costs on support for its branches and obsolete IT [2], but its main feature is the high level of customer's support. This institution could either operate with their own banking license or work on premises of another bank purchasing its financial services wholesale in order to provide retail of them for the clients.

Among the sources of neobank's income it is possible to mention the net interest income (difference between credit and deposit interest rates) and charges. Taking advantage

from the flexible policy, neobank could attract a lot of clients in a short term not issuing the high requirements for them, but the quality of such a credit portfolio would be poor. Thus, there is the high risk for indebtedness to be overdue and the credits to be unpaid. Later the bank could increase the requirements to costumers or even close the unreliable accounts, but these actions would ruin its reputation as in happened with American Simple [3].

When it comes to fees, even if neobank claim that there are no commission payments it is not fair: interchange (commission charges for transactions with banking cards and shares between the bank-card-issuer, bank-processor-of-transaction, payment system and so on) would exist in any case. At the same time, the rate of interchange rate shows the constant downward trend and the banks were to use the mergers and acquisitions strategy to increase profits or charge the subscription fee from costumers.

In order to have the sufficient level of profitability, the neobank should have over than 200,000 clients. Therefore, it pays attention mainly on the retail segment that show more eagerness to left traditional bank, than to corporate sector that could provide it with the greater amount of marginal revenue but requires a lot of time to make the decision about relocating accounts.

Analysis of recent papers. Despite the fact that there is a lack in publications concerning neobanks, there are some sources that allows to analyze this niche in the banking field. For instance, the annual report about the activity of challenger banks provided by Burnmark research center. According to it there were 70 netbanking companies worldwide in 2016 [4]. Taking into account the map of neobanks' spreading within the world shown in Fig.1, it is possible to rate Great Britain as the most popular country of origin of such type of financial institutions. Such tendency is influenced by the number of reasons such as loyal attitude from state regulator (FCA), low level of tax rates, the great number of both investors and employees, opportunity to obtain a special license that reduce the dependence from classic bank. Among 40 British challenger banks the most famous are Atom Bank, Starling Bank, Monzo Bank and Tandem Bank [5].

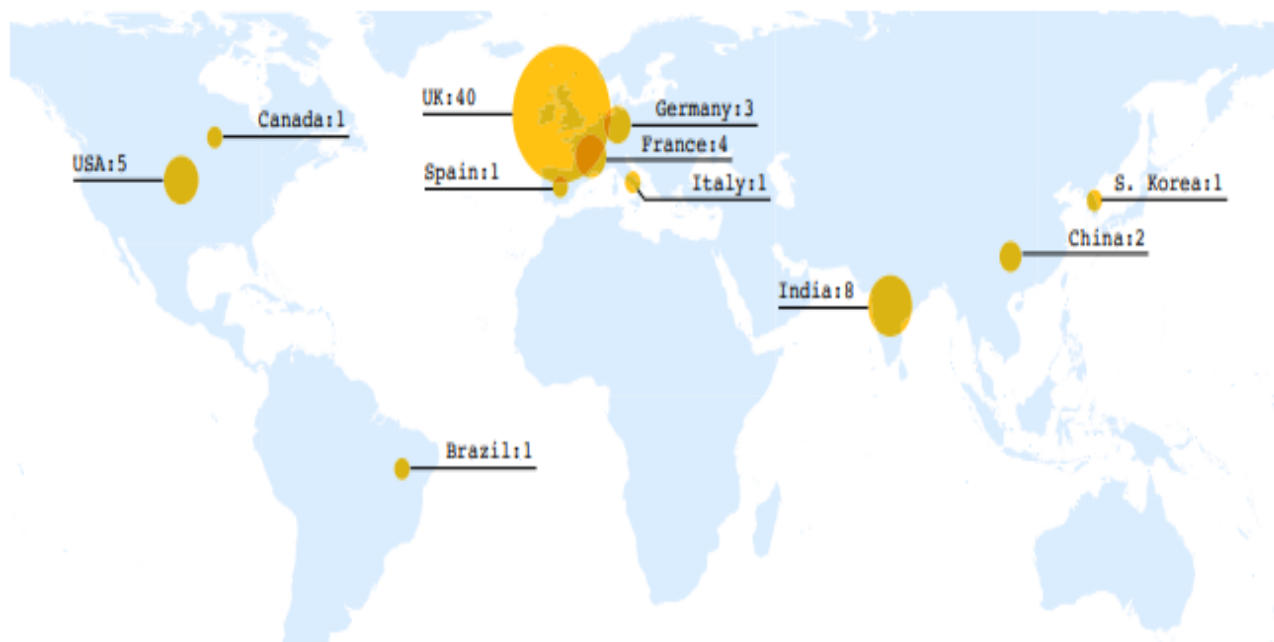


Fig. 1. Locations of Neobanks, October, 2016

Source: [4]

Unsolved aspects of the problem.

When it comes to Ukraine it is become obvious that the nice of neobanks in our country is underdeveloped because it is represented by only one player – Monobank. Consequently, it is crucial to investigate the reasons for Ukraine to

be unpleasant environment for such type of institutions. The challenger Monobank was founded in November, 2017, while the Burnmark research has taken place in October, 2016, that is why it was not marked on the Fig. 1.

Table 1

The comparison of conditions for private clients in neobanks worldwide

Parameters	Monobank (Ukraine)	Rocketbank (the Russian Federation)	Atom Bank (the United Kingdom)	Fidor Bank (Federal Republic of Germany)
Grace period	62 days	-	-	-
Interest rate	3.2% AER	-	1.29% (for 5-year mortgage)	5.99% AER
Commission for money withdrawal	0.5% for own funds and 4% for credit funds	5 free withdrawals per month than 1.5%	Free	3 free withdrawals per month than 1.5%
Replenishment	Free	From another bank’s card for free (from 5000P), in cash in Rocketbank for free, in another bank – 0.5%	Free	Free
Interest on funds balance	10% AER	6.5% AER	2.3% AER	1.2% AER
Cashback	Up to 20%	Up to 10%	-	-

Source: developed by author on the base of [8-11]

The runners of this neobank are represented by the former top-managerial staff of PrivatBank – Dmytro Dubilet, Oleh Horohov-

skiy and Myhailo Rohalskiy. All of them lost their “impeccable business reputation” on the previous workplace: PrivatBank was classified

as an insolvent by the National Bank of Ukraine. Consequently, they face a great resistance trying to obtain the license from NBU and have to work on premises of traditional Universal Bank owned by Serhiy Tihipko [6]. Therefore, Monobank consists of mobile application and traditional credit card issued by Universal Bank, on the accounts of which the funds of neobank's clients will be lying.

Aim of the paper. The article aims at development of the conditions to attract more players to the Ukrainian market of challenger banks and to improve the situation with currently operating institutions.

Materials and methods. The main reason for Ukraine to be unpleasant for start-ups is its legislation. According to the Laws of Ukraine «About licensing of certain types of economic activities» and «About payment systems and transactions» there is only traditional banks that can obtain the permission not only to provide financial credits, but also to issue credit cards in addition to open and maintain the current accounts [7]. In Great Britain there is an opportunity for neobank to get the limited license, whilst in Ukraine it is possible to function on the basis of classic bank or to open accounts and issue payment instruments in the foreign countries (that dramatically increases up-front fees and makes challenger less competitive) or to open a new bank on its own.

Moreover, the decree of NBU №492 from 12.11.2003 says, that identification and verification of the clients during opening the banking accounts in national or foreign currency must be followed by passport's and identification number presentation to bank representative [7]. This point entirely contradicts the key principles of neobank. To meet this requirement the Ukrainian challengers have to hire courier service to open each account, of course it leads to increase in costs and lengthen the time for registration.

However, it is worth to emphasize the readiness of NBU to improve the current situation. It comes without saying that each year the number of people that prefer online-chat to face-to-face discussion with expert increase dramatically. Smartphone application is available over the clock and only requires the internet connection – it doesn't depend on location of the client, his mood or weather conditions. That

is why in order to move with the times NBU approve the program of Ukrainian financial sector development until 2020. It includes really progressive reforms and there is a high probability for them to be implemented.

However, the success of neobanks depends not only on the external factors such as legislation or consumer's preferences, but also on their own unique features that allows to distinguish them from another challenger banks and to obscure the classic ones. If the Ukrainian neobanks are concerned there is no doubt that in the nearest future they would not been able to provide their clients with comprehensive suite of financial products and services because of absence of special banking license. But they could accommodate the needs of their costumers by adhering two main principles of financial innovation: openness and community. Openness refers to the functionality of the bank's application it should not only include the whole number of operations available online, but also its interface should be clear and understandable. Community means building up the strong bonds between the bank and its customers, as well as between the customers themselves. Both of these aspects are implemented in the Monobank's strategy – its application covers the most common banking services such as using credit funds, free payments for utility bills, cellular service, game accounts, fines, taxes, money transfer and so on, additionally its design is developed to be simple for using even if installer of application is not keen on technological advances.

Additionally, the main feature on neobank should be its accessibility. So that the consumers were aware that such an institution exists and have a strong association with it. As far as in Ukraine the majority of people are currently clients of traditional banks, the question is not in attracting the new costumers, but to poach the competitor's ones. Consequently, the advertising campaign of challenger banks should be focused on juxtaposition of modern advantages of neobanks and obsolete cons of traditional players with repetition of its motto. The advertising videos released by Monobank meets these criteria – they highline the banks mobility and announce its key tips «The first mobile bank» and «Cards with credit limit up to 100,000 UAH». It has spent a lot on marketing

through social media, pouring a large amount of resources into making a name for the brand

through Facebook, Telegram, and others.

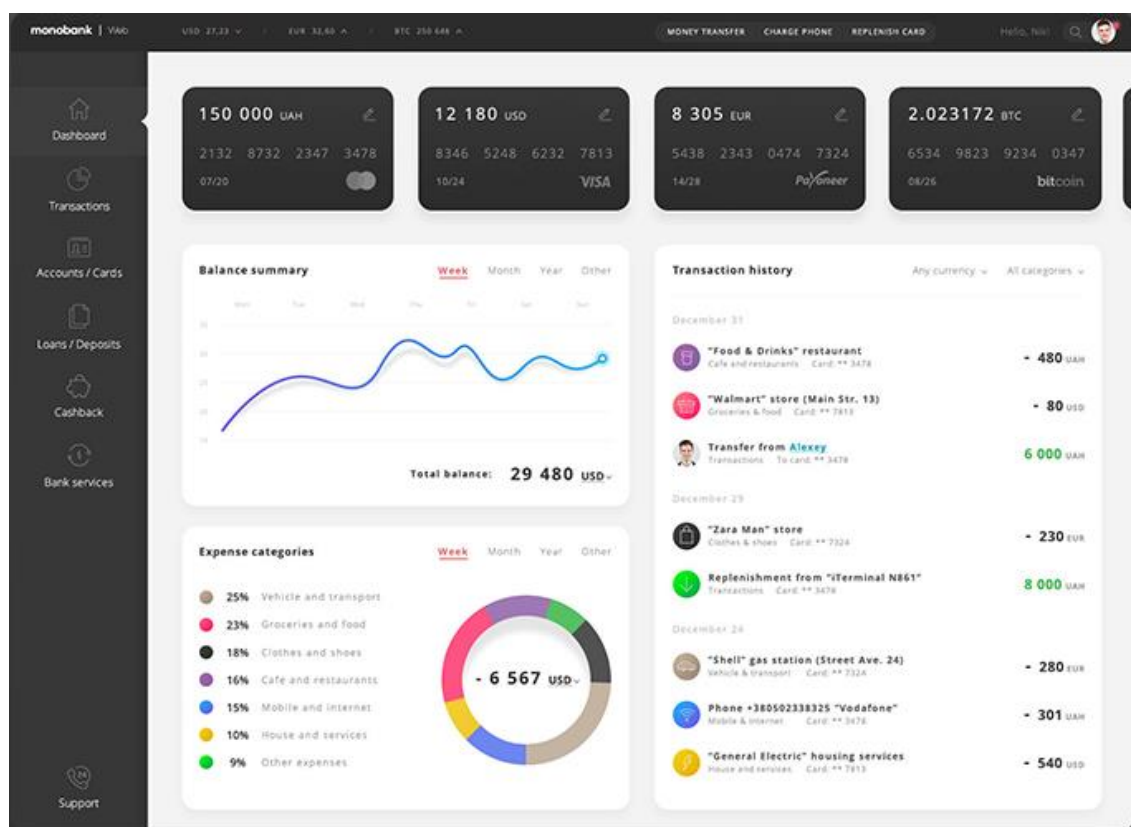


Fig. 2. The interface of Monobank application.

Source: [8]

Moreover, there is another specific feature that could stand out neobanks from other institutions, it is trading cryptocurrencies. It is much easier for bank developed only for functioning in net to provide its clients with the opportunity to make secure payments in Bitcoin. In spite of the fact that Ukrainians show little eagerness to participate in transactions with cryptocurrencies, Monobank provides them with such an opportunity. The crypto-purse is now available for all its clients. The only traditional bank that support these transactions too is PrivatBank. So that, the level of competition in this niche is low. At the same time, a lot of challenger banks in Europe in cooperation with crypto-exchanges introduce the special platforms for operations with Bitcoins and it could possibly be the future of the banking system worldwide.

Growing, the neobank could realize that there are other sources of getting profit except providing clients with banking services, one of them is white label. It is the model of cooperation when one company produced the good and

another sold under its own brand. It is common case within IT-companies to trade with the web-pages formats or developed accounts in social medias, so that the neobanks could sell their own applications. Such kind of partnership contributed to the status of challenger broadening its influence in addition to great increase in funds that could be spent on the development of initial application by making its more unique and recognizable. For instance, despite the fact that Monobank operates on Ukrainian banking market for less than a year, its founders moved to England to run the new project – neobank Kolo on premises of British legislation that is more attractive for start-upper. It would be advent on basis of Monobank’s concept with adoption to British mentality. Its first clients would appear in autumn of 2018 and they would be provided only with the support of payment operations, as far as credit and deposit services need to be investigated further. How could benefit the Ukrainian users of Monobank from such an expansion on European banking market would be obvious later.

At a glance, it is predictable for owners of Kolo to have more opportunities for development with more profits because of favorable legislation background, these extra funds could be spent on improving Monobank's application, also some tips noticed from British competitors could be implemented within Ukraine, and money transfers between London and Kyiv are to be faster and cheaper. This way the ambitions of neobank's runners could contribute to the welfare of the average Ukrainian.

Furthermore, as it was mentioned previously, among the main sources of neobank's income it is possible to mention net interest income and fees and commissions. The last one should be not substantial, in order to support the image of customer-oriented institution. But recently among European challenger banks the new income stream had appeared – it is tech-related activities. For example, even white-labeling could provide neobank with strong revenue growth, because with the rise in partner's popularity the revenue of owners of initial technology increases too. So that the runners of Monobank had formed the FINTECH BAND, the company that provides foreign and Ukrainian banks with IT-services like processing, CRM-system, Internet banking and so on. The revenue from this activity could merge with income from financial activity making neobank more stable and independent. That is why challenger bank start-ups should be proficient and able to provide outsourcing in both fields – banking and technological.

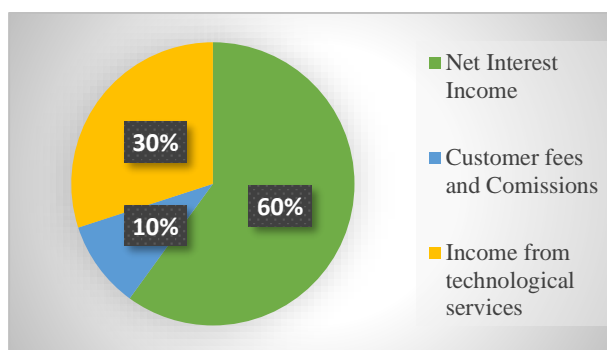


Fig. 3. The appropriate Revenue Distribution of Neobank

Source: developed by author based on [4]

One thing, that is out of attention of Monobank, is creating highly targeted offerings tailored to the characteristics of the user. Such a personalized good could be created only using a

wide range of data analytics. This requires a great amount of cost spent on the research whatever will the company make it on its own or hire the expert agency. Such an investigation campaign is unaffordable for start-up, that is why it should focus its activity on a niche in the micro-segment trying to adopt the functioning of application to its tastes and preferences. Being oriented on millennials the neobank provides its clients with the pack of stickers after registration. There is a humanized cat shown in it since cats are very popular animals among Internet community. Moreover, this cat with QR-code on its neck appears even in application when, for instance, the card is released or the payment is complete. Such a design element cannot be classified as an element of personalization, but it makes usage of application more pleasant and attractive, so that in the nearest future the QR-cat could be as recognizable as the lion from Metro Goldwyn Mayer.

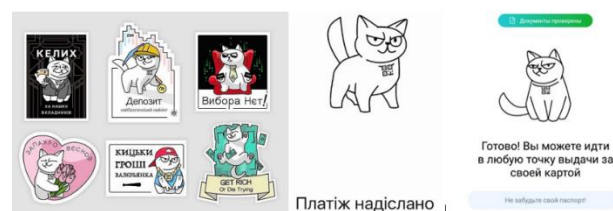


Fig. 4. Using the image of QR-cat in Monobank's stickers and mobile application

Source: developed by author based on [8]

Obviously, many of these recommendations seem common sense, but are hard to implement. For instance, the strategy of customer-centricity had evolved throw-out the last decade from «What are the customer's needs, and how can I help?» to «What can I sell *that* customer?». The marketing and managerial staff in their majority are not enough prepared for such a challenge. They were taught to find out the thing that could accommodate the need of a person, to make it more competitive on the market by reducing costs and, finally, to advent it. But nowadays it is an obsolete view. The modern approach refers to the forming the need in the mind of consumers. In other words, the person has not experienced the lack of something until the firm had offered it. Probably, some clients of traditional banks standing in long ques to cashbox in 2000s can but dream about times when the utility bills could be paid at home, but suddenly the concept of bank even

without branches had appeared. So, that the strategy of successful neobank should followed these steps: decide, what consumer needs and give him more, than he can imagine, only this way the challenger bank could have the advantage against competitors among other start-ups and classic banks.

Another piece of advice concerns facilitating the community. For millennials it is much more acceptable to ask for help from the members of internet-forum or to read the review from the experienced user rather than to bother the official support service or read the instruction. Taking into account this feature a lot of European neobanks introduce the department to moderate the client's community. Within this Internet space people are allowed to communicate with each other, to share their opinions not only about the functioning of banking service, but also about another topic. This way of socialization gives the clients the feeling of involvement. They look much more dedicated to the financial institution and it is more difficult for rivals to poach them. Some challengers in order to increase the social activity within the community introduced some incentives to the participants like financial reward for inviting their friends or just organize the contest for better name for new product, selfie with logo or meaningful comment. Despite the fact that Monobank has no separate socializing platform its clients chat in conventional social media like Facebook, Instagram and Telegram. For example, the founder of Ukrainian neobank Dmytro Dubilet has its own Telegram channel where he shares the news that inspire him or make thoughtful. Here the subscribers could show their attitude towards his post by pressing like or dislike bottom. At the same time on his private Facebook page they are allowed to left comments and to get the answer from the owner of the page. Recently, Dmytro Dubilet had provided the contest concerning finding out the name for the neobank that will be opened by FINTECH BAND in Great Britain this autumn. The brand-name must have the strong Ukrainian background and be easy to pronounce and to remember for the British consumers. The name KOLO was chosen as the most appropriate in spite there is the Polish plumber brand with the same name and in conformity with the Greek language this

word means swearing. Additionally, the post where people were to left their versions of the future challenger's name was by far the most popular on the page. Such an activity could dramatically increase the loyalty and trustfulness to Monobank.

Another suggestion would be to build up the ecosystem around the neobank. It is important for institution to realize that it could benefit not only from providing services to others, but also from consuming ideas. Sometimes the inventing of the new product is much more time-and-money-consuming, than just purchasing it from outside. The main feature of neobank is being flexible, but it is hard to be on top of things of both business model and technology. That is why it is crucial for challenger to be in touch with the research centers and start-ups, adopt the strengths of competitors or even nurture creativity within high university students. For the challenger bank there is no time to rest on its laurels, it should always be in hurry to implement something that could make the using of application easier, the number of services provided – greater and the costs – lower.

Conclusion. It is hard to predict the future of neobank sector. Despite the facts that the number of such institutions increases rapidly each year, some experienced players struggle to survive in the current circumstances. For instance, GoBank make its clients to buy the basic pack of services in the shop that ruins all the concept of neobank as the bank in smartphone, another challenger, Simple, is not able to provide smooth and fast payments or transactions. Accordingly, the friendly service value less for the consumer than appropriate functioning of bank, so that a lot of neobank's clients had returned to the traditional one.

Mentioned above Simple had functioned for five until it was absorbed by the classic bank BBVA, that obtain not only the well-functioning electronic channel, but also the new client base. The path of Simple could be repeated by both neobanks or start-ups that just are planning to be challengers. Through merger and acquisition of technically developed firms the ordinary financial institutions could move with the times and continue functioning both online and offline. For owners of challenger this bargain means that their offspring would continue operating and probably on premises of more

secure organization will obtain its second wind and they could take the pride for its further development, also the additional financial resources they gain could be spent on investigation and it is the question of time when they will return to the banking market with the absolutely new product. However, the main prediction is that the neobanks would have little chances to survive on their own and they will continue functioning as the electronic appendix of classic banks.

Furthermore, the traditional banks could create the electronic analogues of neobanks by themselves and advent it under definitely new brand. There are a lot of examples of such services like UBank (NAB), BankDirect (ASB), Blink (Banamex) or Hello Bank (BNP Paribas). The classic banks have enough resources to launch and support the neobank. The challenger would have access to the service supplement of the bank provided by official license, and the parental would cover another niche. So even if the new player would arise in the banking sector it is highly probable for it to have a traditional bank on the background. This strategy supports the idea of decreasing the number of entirely independent challengers in the market due to high rate of competition and legislation restraints.

In addition, limits established by the state could also questioned the sense of existing of neobanks. In some countries the challengers could not even release the credit card without the support of traditional bank. Such type of challengers is not able to compete with ordinary institutions. Consequently, the consumer would choose the classic bank that could provide more financial services to its clients instead of consumer-centered start-up with over the clock support. And all niche of neobanks would become extinct in these countries.

However, there is a chance for neobanks to overrun the traditional banks with the growing up of the millennials. The generation Z, that highly value all technological advances of modern era, that let them to control their finance and expenditures online would choose challengers rather than classic banks in any case. And each year the number of people, that are eligible to have the current or credit account and refers to this generation increased dramatically. So that the popularity of neobanks would

grew accordingly and in the nearest future they would replace the institutions we used to.

Furthermore, the more people would be interested in opening start-ups that would be in future evolve into neobanks. There are a few reasons for such a tendency. At first, the high rate of profits – the absence of costs for running the branches made it possible to recoup the project in a few years. Even if the owners of the star-up were ought to sell it to traditional bank, their incomes would be substantial. Secondly, the increase in attention from the consumers to non-banking application like Mint or Yodlee that helps to control spending, BillGuard that alert if the person was deceived, CreditCarma that evaluates credit rate, or BrightScope that analyze pension investments give the hope to neobanks too as the demand adjusts supply. And, thirdly, to open the real bank is much more complicated than banking start-up– after the crisis the requirements to the bankers had become very strict, so the only chance for the individual to participate in the banking sector is to run the neobank.

To sum up, it is possible to predict the growing interest to neobanks from both sides - individuals and corporate sector. A few years later these financial institutions would not only compete with classic bank, but also with each other, putting all the efforts to accommodate the costumers needs in the most creative way and broaden the range of services provided (even when it comes to mortgage). As authorities are interested in development of banking system it is just a matter of time when Ukrainian start-ups would be strong enough to compete on the global market.

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НЕОБАНК: МИЛЬНА БУЛЬБАШКА АБО ЗСУВ ПАРАДИГМИ?

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Предметом цієї статті є специфіка сучасних фінансових і банківських ринків. Об'єкт дослідження був виділений в процесі появи принципово нової фінансової установи на банківському ринку під назвою «необанк». Вивчення причин, що викликали його появу, економічних, політичних і соціальних умов його формування, а також його впливу на економічне середовище у всьому світі і конкретних країнах, отримало свій розвиток в цій статті. Основна увага приділяється аналізу ситуації на українському банківському ринку і місця необанків на ньому, на даний момент і побудова прогнозу на найближче майбутнє.

Ключові слова: необанк, мобільний банк, віртуальний банк, інтернет-банк, цифровий банк, фінансова система, банківська система.

НЕОБАНК: МЫЛЬНЫЙ ПУЗЫРЬ ИЛИ СДВИГ ПАРАДИГМЫ?

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Предметом этой статьи является специфика современных финансовых и банковских рынков. Объект исследования был выделен в процессе появления принципиально нового финансового учреждения на банковском рынке под названием «необанк». Изучение причин, вызвавших его появление, экономических, политических и социальных условий его формирования, а также его влияния на экономическую среду во всем мире и конкретных странах, получило свое развитие в этой статье. Основное внимание уделяется анализу ситуации на украинском банковском рынке и месту необанков на нем, в настоящее время и построение прогноза на ближайшее будущее.

Ключевые слова: необанк, мобильный банк, виртуальный банк, интернет-банк, цифровой банк, финансовая система, банковская система.

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