

Neo-Banking in India: Opportunities and Challenges in the Digital Financial Ecosystem

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ABSTRACT

This paper examines the development and current state of neo-banking in India, analyzing its evolution, major opportunities, and regulatory challenges within the digital financial ecosystem. Using secondary empirical data from credible industry reports, financial news and regulatory sources, the study highlights the rapid growth of neo-banking driven by digital infrastructure, demographic trends, and innovative fintech models. It also critically evaluates regulatory ambiguity, operational constraints, and cyber security risks that shape India's neo-bank landscape. Neo-banking has emerged as a transformative force within India's rapidly evolving digital financial ecosystem. This study examines the development, structure, and current dynamics of neo-banking in India, with a focus on its evolution, growth drivers, opportunities, and regulatory challenges.

Drawing upon secondary empirical data from industry reports, financial publications, and regulatory sources, the paper highlights how advancements in digital infrastructure, increasing smartphone penetration, and demographic shifts toward technology-oriented consumers have accelerated the adoption of neo-banking services. The study further analyzes the role of fintech innovation in enhancing customer experience, financial inclusion, and cost efficiency within the banking sector. At the same time, it critically evaluates key constraints, including regulatory ambiguity due to the absence of standalone licensing frameworks, operational dependence on partner banks, and rising cybersecurity threats in a fully digital environment. The findings suggest that while neo-banks hold significant potential to reshape financial service delivery in India, their long-term sustainability depends on regulatory clarity, robust risk management, and strengthened consumer trust. The research contributes to understanding the intersection of digital innovation and financial regulation in emerging economies.

Keywords: Neo-banking, Digital Banking, FinTech, Financial Inclusion, Regulatory Challenges, Cybersecurity Risk, Digital Payments

INTRODUCTION

Neo-banking represents a modern banking paradigm that delivers financial services through fully digital platforms without traditional physical branches. These institutions leverage technologies such as cloud computing, artificial intelligence (AI), data analytics, and mobile applications to offer cost-efficient, personalized services (Monis & Pai, 2023). Globally, neo-banks have emerged as challengers to legacy banking systems, particularly among digitally native consumers. In India, neo-banking growth is closely linked to the development of digital public infrastructure, including Aadhaar-based identification, e-KYC, and the Unified Payments Interface (UPI), which have reduced onboarding friction and enhanced digital transaction adoption (Kailashbhai, 2025). However, unlike digital banks in some advanced economies, Indian neo-banks operate without standalone banking licenses. Instead, they partner with licensed banks, creating a hybrid model that enables innovation but introduces regulatory and operational dependencies (TaxGuru, 2025).

Demographic trends further fuel this growth. Millennials, Gen Z users, gig workers, and MSMEs increasingly prefer mobile-first financial solutions with minimal paperwork and real-time insights (Birla & Arya, 2025). Yet, rapid digitization also exposes the sector to cyber threats and regulatory uncertainty (Waliullah et al., 2025). This study therefore investigates the evolution, opportunities, and regulatory challenges of neo-banking in India's digital financial ecosystem. Neo-banking

has emerged as a transformative force within India's rapidly evolving digital financial ecosystem. This study examines the development, structure, and current dynamics of neo-banking in India, focusing on its evolution, growth drivers, opportunities, and regulatory challenges. Using secondary empirical data from industry reports, financial publications, and regulatory sources, the paper highlights how digital infrastructure expansion, smartphone penetration, and demographic shifts toward technology-oriented consumers have accelerated adoption of neo-banking services. The study further evaluates fintech innovation in enhancing customer experience, financial inclusion, and cost efficiency (Birla & Arya, 2025; Rajitha & Sivakumar, 2019). At the same time, it critically examines constraints such as regulatory ambiguity, operational dependence on partner banks, and increasing cybersecurity risks in a fully digital environment (Waliullah et al., 2025; Javaheri et al., 2023). Findings indicate that neo-banks hold significant potential to reshape financial service delivery in India, but their long-term sustainability depends on regulatory clarity, strong risk governance, and consumer trust.

The study contributes to understanding the intersection of digital innovation and financial regulation in emerging economies. Neo-banking represents a modern banking paradigm leveraging digital technologies to provide financial services through mobile and online platforms without the need for traditional physical branches. Neo-banks are built on technology platforms, offering services such as payments, savings, budgeting tools, and lending interfaces, often with enhanced user experiences and competitive pricing (Fortune India, 2026). However, in India, neo-banks operate without direct banking licenses; instead, they partner with licensed banks to deliver regulated services, making their legal status and risk profiles unique compared to both traditional banks and fully licensed digital banks abroad. The global financial services industry is experiencing a profound digital transformation, driven by rapid technological innovation, changing consumer expectations, and the expansion of internet-enabled financial ecosystems. Among the most significant developments within this transformation is the emergence of neo-banks—fully digital financial service providers that operate without traditional brick-and-mortar branches. Neo-banks leverage advanced technologies such as cloud computing, artificial intelligence, data analytics, and mobile platforms to offer seamless, user-centric banking experiences.

Their business model focuses on low operational costs, agile product development, and highly personalized services, positioning them as disruptive actors in modern banking systems. In India, the rise of neo-banking is closely linked to the broader evolution of the country's digital economy. Over the past decade, India has built a robust digital financial infrastructure through initiatives such as Aadhaar-based identification systems, e-KYC processes, the Unified Payments Interface (UPI), and widespread mobile connectivity. These developments have significantly reduced entry barriers to financial services and encouraged innovation within the fintech sector. As a result, neo-banks have emerged as an important component of India's digital financial ecosystem, offering services that range from digital savings accounts and payment solutions to budgeting tools, expense tracking, and small business financial management. Unlike traditional banks, neo-banks in India do not possess independent banking licenses. Instead, they operate through partnerships with licensed financial institutions that provide core banking services while neo-banks manage customer interfaces and digital service delivery. This hybrid model enables rapid innovation and expansion but also introduces structural dependencies and regulatory complexities. The absence of a dedicated licensing framework for neo-banks creates ambiguity in areas such as consumer protection, data governance, compliance responsibility, and risk management. Consequently, understanding the regulatory environment is essential to evaluating the sustainability of the neo-banking model.

The growth of neo-banking is further fueled by demographic and behavioral trends. A large segment of India's population—particularly millennials and Generation Z—demonstrates a strong preference for mobile-first, on-demand financial services. Additionally, the expansion of the gig economy and the increasing digitalization of small and medium enterprises (SMEs) have created demand for flexible, technology-driven financial solutions. Neo-banks respond to these needs through intuitive applications, real-time analytics, and low-cost service structures, contributing to financial inclusion and enhanced accessibility. However, the rapid expansion of digital banking also brings significant challenges. Cybersecurity risks, digital fraud, and vulnerabilities associated with third-party integrations pose serious threats to consumer trust and system stability. Moreover, competition from traditional banks that are accelerating their own digital transformation intensifies market pressures. Regulatory authorities must balance innovation with systemic stability and consumer protection, making the governance of neo-banking a complex policy issue. Against this backdrop, this study aims to examine the evolution, opportunities, and regulatory challenges of neo-banking in India.

By analyzing secondary empirical data and industry insights, the paper seeks to provide a comprehensive understanding of how neo-banks are reshaping India's financial landscape, the benefits they offer, and the structural constraints they face. The research contributes to the growing body of literature on fintech innovation and regulatory adaptation in emerging economies, highlighting the intersection of technology, finance, and governance in the digital era. This research paper explores how neo-banking has evolved in the Indian financial ecosystem, its growth potential, the regulatory environment that frames its operations, and the key challenges neo-banks face today. The empirical analysis draws on market research, industry data, and regulatory sources to provide a comprehensive understanding of this dynamic sector. The financial

services landscape is undergoing a transformative shift, characterized by the rise of neo-banks – financial institutions that deliver digital banking services without traditional physical branches. Neo-banks leverage technology and data to provide personalized, cost-effective, and convenient services tailored to a digitally savvy customer base. Their emergence is a direct outcome of digitalization trends in the broader banking ecosystem, along with innovations in mobile technology, secure payments infrastructure, and regulatory initiatives facilitating digital economic growth. In India, neo-banking has grown from niche fintech applications to significant players in retail financial services. This growth occurs in the context of India's wider push towards financial inclusion, digital payments dominance, and government initiatives like Digital India and the Unified Payments Interface (UPI). Yet, this growth is accompanied by key regulatory uncertainties, cyber security threats, and operational challenges. The present study investigates the evolution, opportunities, and regulatory challenges of neo-banking within India's digital ecosystem.

neo-banking growth is strongly linked to India's digital payment infrastructure, smartphone penetration, and financial inclusion initiatives. High digital transaction volumes indicate user readiness for app-based financial services.

Evolution of Neo-Banking in India

The neo-bank phenomenon in India began in the 2010s, influenced by global digital banking trends. However, growth accelerated sharply in the 2020s due to rapid digital adoption and supportive infrastructure. By the mid-2020s, India's neo-bank market expanded at *over 50% CAGR*, one of the fastest rates globally. User projections estimate close to *60 million neo-bank users by 2027*, compared to fewer than 6 million in 2021. This adoption growth has been fueled by improvements in mobile connectivity, increased smartphone penetration, and the proliferation of digital payment systems like UPI, which processed billions of transactions monthly. Neo-banks originated in developed markets like Europe and North America before gaining traction in emerging economies. India's digital ecosystem, with over 800 million internet users and widespread smartphone usage, created an enabling environment for such digital banking models. In the early 2020s, neo-bank initiatives began expanding rapidly, driven in part by the post-pandemic acceleration of digital adoption. By 2025, the neo-banking market in India was one of the fastest growing globally, expanding at a compound annual growth rate (CAGR) exceeding 50%. Users were projected to exceed 60 million by 2027, up from fewer than 6 million in 2021.

Researchers describe neo-banks as fully digital, branchless financial institutions that leverage advanced digital technologies to deliver banking services in a highly customer-centric manner. These platforms disrupt traditional banking by offering intuitive mobile interfaces, faster services, and cost-effective solutions (Sardar & Anjaria, 2023). Neo-banks provide personalized features, such as automated budgeting and real-time financial management tools, which differentiate them from legacy systems with slower innovation cycles. In the Indian context, neo-banks are recognized as early adopters of FinTech innovations that reduce operational costs and improve accessibility for tech-savvy customers (Raut, 2025). By harnessing digital infrastructure and mobile platforms, neo-banks bridge gaps that traditional banks find difficult to fill due to legacy systems and physical branch dependencies.

Empirical research highlights convenience factors—such as ease of access, low transaction costs, and superior digital usability—as significant determinants of neo-bank adoption in India. Birla & Arya (2025) find that such factors significantly influence user intentions to adopt neo-banking services, demonstrating that digital usability and perceived service quality encourage financial inclusion and user satisfaction. Complementary studies emphasize that customer perception plays a critical role in neo-banking acceptance. For instance, users report that neo-banks bridge service gaps between traditional banking offerings and digitally oriented consumer expectations, especially since the COVID-19 pandemic accelerated contactless financial interactions and digital services adoption.

Literature on neo-banking trends illustrates how business models differ from conventional banks. Rajitha and Sivakumar (2019) analyze growth patterns of neo-banking, noting that the sector experienced substantial expansion at a compound annual growth rate (CAGR) of over 50% in its early years, driven by collaborations between fintech startups and licensed banks in India. Zenodo research also indicates that neo-banks in India rely on partnerships with traditional banks and fintech ecosystems to deliver digital financial services, creating both opportunities and challenges in terms of autonomy, scalability and brand recognition.

Several studies highlight potential benefits and barriers in the neo-banking landscape. Sohal and Singh (2024) analyze the opportunities neo-banks present, such as inclusive financial access for underbanked populations and service affordability, while also pointing out challenges like technology reliance, cybersecurity vulnerabilities, and regulatory complexities that could hinder adoption. A systematic literature review on cybersecurity and digital banking underscores that increased digitalization exposes financial platforms to phishing, malware, and data breaches, which can erode consumer trust if not properly mitigated through robust security protocols. This research points to the importance of stringent cybersecurity measures for maintaining confidence in digital financial services.

Comparative analyses within the literature reveal that neo-banks outperform traditional institutions in terms of agility, speed of innovation, and customer experience, while traditional banks retain strengths in regulatory clarity, deposit protection, and trust associated with established brand identities. Sharma (2024) examines financial performance indicators and finds structural differences that reflect the distinct operational ecosystems of neo-banks versus legacy banks. The literature underscores that neo-banking is a significant digital innovation reshaping India’s financial services. The literature collectively acknowledges that neo-banks enhance customer experience, reduce costs, and leverage technology for broader financial inclusion, while also calling attention to regulatory, operational, and security challenges that must be managed to sustain growth. This review establishes a foundation for analyzing neo-banking evolution, opportunities, and regulatory challenges within India’s digital financial ecosystem.

Table1: Comparison between Traditional Banks and Neo-Banks

Basis of Comparison	Traditional Banks	Neo-Banks
Physical Presence	Branch-based	Fully digital, no branches
License Status	Full banking license	Operate via partner banks
Cost Structure	High operational costs	Lower overhead costs
Customer Experience	Often slower, paperwork heavy	Fast, app-based, seamless
Innovation Speed	Slower due to legacy systems	Rapid product innovation
Technology Use	Gradual digital adoption	Core technology-driven
Customer Trust	High trust, long history	Still building trust
Target Users	Broad demographic	Youth, freelancers, MSMEs
Regulatory Oversight	Directly regulated by RBI	Indirect regulation via partner banks
Revenue Model	Loans, deposits, fees	Fees, subscriptions, partnerships
Risk Exposure	Credit & operational risks	Tech, cyber, and compliance risks
Financial Inclusion Role	Historically limited reach	Strong potential via mobile access

REVIEW OF LITERATURE

Neo-banking is widely viewed as part of the FinTech revolution disrupting traditional financial intermediation (Monis & Pai, 2023). Studies indicate that neo-banks enhance user experience, reduce cost structures, and deploy faster innovation cycles compared to legacy banks (Rajitha & Sivakumar, 2019).

Adoption studies in India show that convenience, digital usability, and perceived service quality significantly influence customer acceptance (Birla & Arya, 2025). Research also emphasizes the enabling role of India’s digital infrastructure — particularly UPI and Aadhaar — in fostering neo-bank expansion (Kailashbhai, 2025).

However, scholars highlight regulatory ambiguity as a major concern because neo-banks lack direct licenses and depend on partner banks (Raut, 2025). Cybersecurity literature further warns that digital banking platforms face phishing, malware, and API vulnerabilities, potentially undermining trust (Javaheri et al., 2023; Waliullah et al., 2025).

Neo-banking is part of the broader FinTech trend where technology companies disrupt legacy financial services by enhancing customer experience, reducing cost structures, and delivering innovative product offerings. Globally, neo-banks have emerged as significant challengers to traditional banking, particularly among digitally native populations. In India, the digital ecosystem — built around UPI, Aadhaar-enabled e-KYC, and pervasive smartphone usage — has provided fertile ground for neo-bank experimentation and adoption.

However, literature also points to regulatory challenges in India, where direct banking licenses are unavailable to neo-banks. This intermediate model — where neo-banks must partner with licensed banks — creates operational dependencies and regulatory ambiguities that can complicate consumer protections and crisis responses.

Previous studies emphasize both the opportunities in financial inclusion and innovation, as well as challenges including trust, cyber security risks, and unclear regulatory oversight, especially concerning data protection, outsourced service compliance and customer grievance mechanisms.

Neo-banking represents a blend of financial innovation and technology (FinTech), redefining how consumers interact with financial products. Unlike traditional banks, neo-banks typically lack full banking licenses and instead partner with licensed banks to provide banking services – including deposit accounts and payments – while managing customer experience,

product design, and digital interfaces themselves. This model has implications for regulatory oversight, financial security, and service scalability.

A foundational concept in digital banking transformation is infrastructure enablers such as UPI, Aadhaar-based e-KYC, and mobile penetration, which significantly reduce onboarding friction and facilitate real-time financial services delivery. These digital stack components form the backbone of India's neo-banking growth story.

The literature on neo-banking reveals a multi-dimensional landscape where digital innovation reshapes traditional financial services, supported by technological advancements, evolving customer preferences, and regulatory adaptations. This review synthesizes key findings from scholarly articles, industry reports, and empirical studies to contextualize the development of neo-banking, particularly in the Indian context.

Objectives

The present study objectives to analyze the development and role of neo-banking within India's digital financial ecosystem. The specific objectives are:

1. To study the evolution of neo-banking in India.
2. To find out the business models and SWOT analysis of neo-banks.
3. To identify major opportunities and challenges of neo-banking.

RESEARCH METHODOLOGY

This study employs a descriptive and analytical research design using secondary data. Sources include RBI publications, industry reports, financial research studies, and academic journals. Data analysis techniques include trend analysis, SWOT analysis, and comparative analysis of neo-banks versus traditional banks. Data triangulation ensures validity. This study adopts a descriptive and analytical research design based on secondary empirical data. The research seeks to understand trends, patterns, and structural issues within India's neo-banking ecosystem by analyzing existing quantitative and qualitative data. A descriptive research design is employed to systematically document the characteristics, growth trends, and operational models of neo-banks in India. Simultaneously, an analytical design is used to evaluate regulatory frameworks, risks, and economic implications. The research design integrates:

- Market trend evaluation
- Institutional and policy analysis
- Comparative structural assessment

This design enables a holistic understanding of both the functional and regulatory dimensions of neo-banking. The study is based entirely on secondary data, which includes both quantitative indicators and qualitative policy information. Data have been collected from credible and authoritative sources to ensure reliability.

Evolution of Neo-Banking in India

Neo-banking in India gained momentum during the 2020s, expanding at a CAGR exceeding 50% in early years (Rajitha & Sivakumar, 2019). User estimates indicate growth from 6 million users in 2021 to nearly 60 million by 2027. This rapid expansion reflects smartphone penetration, mobile internet growth, and the dominance of UPI transactions (Kailashbhai, 2025).

Business Models and Opportunities

Neo-banks function as digital front-end platforms while partner banks provide regulated infrastructure. This structure reduces overhead costs and accelerates product innovation (Monis & Pai, 2023). Opportunities include:

- Financial inclusion in underserved regions
- MSME financial management solutions
- AI-driven personalization
- Cross-selling financial products

Government initiatives like PMJDY further support inclusion efforts.

Business Models and Opportunities

Neo-Banking Business Models-Neo-banks in India typically operate as front-end digital platforms that manage customer interaction while outsourcing regulatory and core banking functions to partner banks. This model lowers operational costs and accelerates product deployment but also introduces dependency on licensed entities. Examples include digital banking

platforms like Jupiter, Fi Money, and Razorpay X, which offer services including zero-balance accounts, automated savings tools, and business structures for SMEs.

Opportunities in Financial Inclusion - India's vast unbanked and underbanked population presents a significant opportunity. Government programs like the Pradhan Mantri Jan Dhan Yojana have opened over 500 million accounts, signaling a broad base for digital financial inclusion. Neo-banks can leverage this by offering personalized financial products to underserved segments, bridging gaps left by traditional banks.

Table 2: Growth Trajectory of Neo-Bank Users in India

Year	Estimated Users (Millions)
2021	6
2022	12
2023	22
2024	35
2025	45
2026	52
2027	60

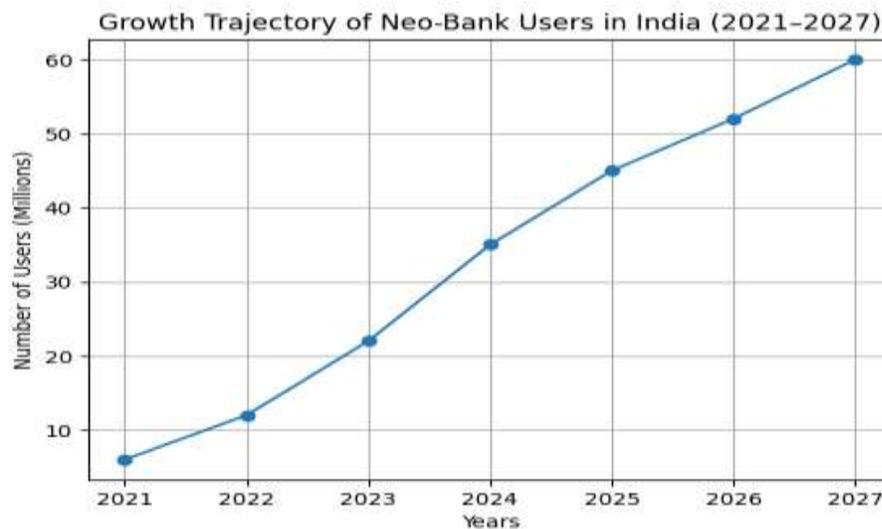


Figure 1: Growth Trajectory of Neo-Bank Users in India

The figure clearly demonstrates an exponential growth pattern in neo-bank user adoption from 6 million users in 2021 to an estimated 60 million by 2027. This rapid rise reflects:

- Expansion of digital payment infrastructure (UPI ecosystem)
- Growth in smartphone and internet penetration
- Increasing trust in fintech-driven financial services
- Demand for mobile-first, low-cost, personalized banking solutions .This visual strongly supports your argument regarding the accelerated diffusion of neo-banking in India's digital financial ecosystem.

Neo-Banking Market Size and Growth

India's FinTech sector has seen exponential growth, with digital payments and neo-banking playing pivotal roles. In FY2024, the combined lending, payments and neo-banking market reached roughly ₹68 trillion, with neo-banking alone accounting for ₹5.6 trillion, indicating its significant contribution to the broader FinTech ecosystem. India has witnessed a digital payments revolution, with digital transactions dominating the economy. In the first half of 2025, digital payments accounted for 99.8% of total transaction volume and 97.7% of total transaction value in the country, reflecting deep penetration of digital infrastructure. This growth not only underpins neo-bank adoption but also highlights the shift away from cash and traditional banking channels for routine transactions.

User Adoption Patterns and Demographics

Millennials and urban youth are significant adopters of neo-bank services. Their preference for digital experiences, convenience, and minimal fees aligns well with neo-bank offerings. Surveys indicate that security concerns and trust remain key barriers, with over 65% of users citing cybersecurity as a major concern in digital banking adoption. This demographic trend highlights the role of behavioral factors and technology acceptance in shaping neo-bank growth.

Digital Payment Ecosystem and Neo-Banking Adoption

India’s digital payments infrastructure — particularly the Unified Payments Interface (UPI) — has catalyzed digital financial inclusion. UPI reached record monthly transaction volumes exceeding 20 billion by August 2025, with transaction values nearing ₹25 lakh crore, reflecting robust digital payment adoption across demographics and geographies. This widespread adoption of digital payments has lowered transaction friction and increased consumer comfort with digital financial services, creating a conducive environment for neo-bank products such as digital savings accounts, automated payments, and integrated financial management tools.

Neo-Banking Business Models and Customer Segments

Operational Structures

In India, neo-banks operate without standalone licenses. They rely on partnerships with regulated banks that hold core banking licenses. For example, platforms like Jupiter, Fi Money, Niyo, and RazorpayX work with partner banks such as Federal Bank, Yes Bank, and others to offer banking services digitally. This partnership model enables neo-banks to offer services like digital accounts, UPI integration, virtual debit cards and savings products without maintaining their own regulated banking infrastructure. However, it also introduces constraints related to control over regulatory compliance and service delivery timelines.

Customer Segmentation

Neo-banks in India primarily attract:

- Millennials and Gen Z users who prefer mobile-first, personalized financial experiences.
- Gig economy workers and freelancers, seeking streamlined payment and financial management tools.
- Small businesses and MSMEs that benefit from automated payroll and simplified accounting tools.
- Underserved demographics previously hesitant to adopt traditional banking due to accessibility barriers. This diversified user base underscores the role of neo-banks in financially integrating previously underserved segments.

Regulatory and Risk Challenges

India does not provide standalone digital banking licenses, creating regulatory grey areas (TaxGuru, 2025). Operational dependence on partner banks restricts autonomy. Cyber security risks are substantial, as digital platforms face data breaches and fraud threats (Javaheri et al., 2023; Waliullah et al., 2025). Building consumer trust remains a key challenge.

SWOT Analysis

Table 3: SWOT Analysis of Neo-Banking in India

Strengths	Weaknesses
Fully digital, branchless model reduces operational costs	No independent banking license in India
Superior user experience (UX), mobile-first design	Dependence on partner banks for core services
Faster innovation and product deployment	Limited control over regulatory compliance
Data-driven personalization and AI-based insights	Lower customer trust compared to traditional banks
Appeals to millennials, Gen Z, and tech-savvy users	Profitability challenges due to thin margins
Opportunities	Threats
Expanding financial inclusion in rural & semi-urban India	Regulatory tightening by RBI
Growth of UPI and digital payment ecosystem	Rising cybersecurity threats and digital fraud
AI, big data, and embedded finance integration	Competition from traditional banks’ digital arms
MSME and gig economy financial solutions	Data privacy and compliance risks
Cross-selling of insurance, investments, and credit	Market saturation and fintech consolidation

The SWOT framework shows that neo-banks are strong in innovation and digital efficiency but remains structurally vulnerable due to regulatory dependency and cyber security risks.

Opportunities in India's Neo-Banking Sector

Financial Inclusion and Accessibility -India's initiatives like the Pradhan Mantri Jan Dhan Yojana (PMJDY) opened banking services to millions, establishing a base for digital financial inclusion. Increased smartphone penetration has further expanded access to neo-banking services even in semi-urban and rural areas. Neo-banks can extend financial services to customers who may not engage with traditional banks due to geographical, financial or procedural barriers, thereby improving economic participation.

Emerging Technology Opportunities -Technologies such as artificial intelligence (AI), machine learning, and real-time analytics enhance neo-bank personalization and financial planning tools. Neo-banks can integrate features like automated savings pods, spending insights and predictive personal financial advisory services, differentiating them from traditional banking offerings. This focus on technology-driven customer journeys positions neo-banks as innovators in personal finance management.

Regulatory Environment and Challenges

Licensing and Oversight-

India's regulatory stance does not permit fully digital banks with independent banking licenses. Neo-banks must rely on partnerships with licensed commercial banks and are indirectly regulated through these partners. RBI guidelines govern payments, digital lending, and related activities but do not offer a dedicated framework for neo-banks, creating ambiguity regarding prudential norms, data protection duties and risk management obligations.

Regulatory Framework in India-

Unlike certain developed economies where digital banks can obtain direct digital banking licenses, India currently does not grant standalone neo-bank licenses. As a result, neo-banks must collaborate with traditional banks to deliver banking products under existing regulatory umbrellas. This regulatory ambiguity limits neo-banks' ability to innovate independently and restricts services like loans and credit offerings.

Compliance and Cyber security Risks –

Cyber security threats are a central challenge for digital banking platforms. With rising digital fraud and attacks, regulators and financial institutions alike are increasingly focusing on risk mitigation. The RBI has flagged increasing fraud incidents in digital payments, prompting initiatives such as secure domain names for financial entities to enhance trust.

Comparative Insights with Traditional Banks

While traditional banks now provide digital services internally, neo-banks often excel in agile product deployment and customer experience. Traditional banks' strengths lie in deposit insurance, branch networks, and deeper regulatory clarity, whereas neo-banks compete on innovation and cost efficiency.

Cyber security and Fraud Risk-Cyber threats pose significant risks in a sector that is fully digital. Neo-banks rely on multiple third-party APIs for services like KYC, payment processing, and credit scoring, exposing multiple potential points of vulnerability if these interfaces are inadequately secured. Additionally, incident reporting and breach response systems are not standardized for neo-banks, unlike the specific mechanisms mandated for traditionally regulated banks.

Data analysis and Interpretation

Neo-banking in India stands at a pivotal intersection of technology and financial services. Its rapid growth aligns with broader economic digitalization and demographic shifts toward mobile-centric financial behaviors. Strong infrastructure foundations, such as UPI and extensive smartphone usage, have fueled neo-bank adoption, particularly among younger and underserved cohorts. However, regulatory ambiguity, operational constraints due to dependency on partner banks, and cyber security vulnerabilities present complex challenges that must be addressed by policymakers and industry stakeholders. The primary drivers for neo-banking growth in India include technological infrastructure (smartphones, UPI), consumer preferences for digital financial experiences, and policy initiatives targeting inclusive finance.

Challenges Facing Neo-Banks in India

Despite strong growth momentum, neo-banks face several significant challenges in the Indian context:

Regulatory and Licensing Constraints-

Most neo-banks in India do not have standalone banking licenses and must operate through partnerships with licensed banks. This limits their ability to independently offer a full suite of banking products such as lending or deposit insurance products. Additionally, the regulatory framework for digital-only banks remains evolving, creating uncertainty for long-term planning and innovation.

Cyber security and Trust Issues-

Being entirely digital exposes neo-banks to cyber security risks, including data breaches and fraud, which can significantly erode user trust. Users often perceive traditional banks as more secure due to their physical presence and long-established reputations, making trust building a major hurdle for digital-only players.

Limited Financial Literacy and Rural Adoption-

Digital literacy and connectivity gaps, particularly in rural areas, pose barriers to neo-banking adoption among vast segments of the population. Limited understanding of financial products can also reduce uptake of more complex services such as investment and credit products.

Competition and Profitability-

Neo-banks face intense competition not only from traditional banks that are rapidly digitizing their services but also from fintech super-apps integrating financial services with other digital offerings. Additionally, many neo-banks prioritize user growth over profitability, creating sustainability challenges.

Future Prospects**Regulatory Evolution**

A dedicated regulatory framework for digital-only licenses would enable neo-banks to operate with more autonomy and expand offerings like credit and lending products. Emerging regulatory initiatives, including fintech sandboxes and self-regulation codes, may further improve governance and trust within the ecosystem.

Technological Advancements

Artificial intelligence (AI), machine learning (ML), and advanced analytics will drive personalised services, risk monitoring, and fraud detection — strengthening neo-banks' competitive advantage. Embedded finance and Banking-as-a-Service (BaaS) platforms will further unlock new revenue streams and broaden fintech-bank collaboration models.

Product Diversification and Inclusion

Neo-banks are poised to expand into wealth management, MSME lending, insurance distribution, and supply-chain finance, thereby increasing revenue density and user engagement. There is also potential for neo-banks to improve financial inclusion by serving underserved populations, including women, micro-entrepreneurs, and rural users, as digital literacy and connectivity improve.

CONCLUSION

This research highlights that neo-banking in India is a dynamic and rapidly evolving sector with the potential to significantly enhance financial inclusion and user-centric financial services. The growth trajectory is supported by strong digital infrastructure and emerging technologies but is constrained by regulatory uncertainties and systemic risks. For neo-banking to reach its full potential, a clear regulatory framework that balances innovation with consumer protection and systemic stability is essential. Neo-banking in India stands at a critical juncture. The sector has achieved remarkable growth, supported by robust digital payment systems and broad adoption trends. However, realizing its full potential hinges on regulatory clarity, strengthened cyber security frameworks, and enhanced trust among users. Future research should evaluate longitudinal data on neo-bank performance, customer behavior trends, and evolving regulatory policies to better understand the long-term sustainability of neo-bank business models.

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