



## Neo Banks: Assessing Risk Factors Contributing to their Failures

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### ABSTRACT

The current study evaluates key risks which result in Neo Banks' failure within emerging economies such as Pakistan. This research examines economic along with political elements and regulatory requirements and compliance risks and their synergy toward the continued operation of these online-only banks. Data was collected through structured questionnaires to carry out a quantitative research design. The survey collected responses from 225 people including banking experts combined with fintech professionals along with SME business owners and personal consumers. The association between risk factors and Neo Bank failure was analyzed using descriptive statistics in conjunction with correlation and regression methods which were computed on SPSS. The research data showed that risk association strongly matched ( $r = 0.682$ ,  $p = 0.000$ ) with failure causes. The results show risk association produces 46.5% variance in failure causes according to regression analysis ( $R^2 = 0.465$ ). Effective risk management measures become necessary for Neo Banks because economic instability and political uncertainties along with regulatory restrictions and compliance issues continue to lead to their failure. As these findings demonstrate the implementation of strong risk mitigation practices including enhanced regulatory compliance better cyber security measures and revenue stream diversity has become crucial to Neo Banks' operational success. The regulatory authorities and financial establishments should establish regulatory systems to promote Fintech innovations while maintaining banking safety. New research provides statistical evidence which enriches knowledge about Neo Banks' difficulties in emerging markets so it complements existing works on fintech sustainability. Digital banking becomes more sustainable through the valuable recommendations outlined in the research which address regulators' needs and investors' demands and fintech entrepreneurs' operations.

## Introduction

The term “Neo Banks,” also known as digital only or challenger banks, seems like an umbrella term for the banks that have no physical existence but still manage to anticipate their services (Bhattacharjee et al; 2022). They offer a variety of services in comparison of traditional banks, just

like account openings, issuing Cheque books, performing financial transactions, and handling different queries regarding day-to-day banking operations; all as similar to traditional banking but with an improvised focus of web-based & branchless platforms (Bhattacharjee et al; 2022).

According to the Yield Report (2020), via innovations in technology & uptakes in internet facility, neo banks would surely fuel up their growth in the time being. However, the risk association would also escalate as RBI has reported 604 billion Indian Rupees fraud in the fiscal year 2022 (Statista 2022). Neo Banks comprise of a “business model in which the production & delivery of banking products & services are relied on technology - enabled innovation. (ECB 2018: p.3) hence we are still in “early or growth days” of neo banks & they pose us numerous questions regarding different aspects of them. Neo Banks mainly uses Fin tech innovations leading towards the betterment of the banking industry in their services & production. According to KPMG (51), \$60.2B was invested in Fin Tech companies across 2,914 deals in 2017, \$150.4B across 3,639 deals in 2018, and \$150.4B across 3,286 deals in 2019. This increased volume in the Fin Tech clearly states the rise of technology & how they have impacted the human lives especially in banking industry. Neo banks aim to disrupt traditional banking by providing a seamless and user-friendly banking experience through their digital platforms. According to (Stagmeier & Friedental, 2020) there were 256 Neo banks around the globe & surely this number would be increasing till date according to customer needs & preferences. Naser 2019 states that Neo banks could operate without full banking license as they do not have any physical or traditional existence but they require license for their provision of financial services. Nowadays Neo Banks are using cut-edge technology in order to cope with future requirements & provide seamless user experience with lower fees, greater transparency, convenient & 24 hours banking, personalized financial tools along with technology based young consumers as compared to traditional banking. (Koen Meijer, 2021)

Origin of Neo Banks began emerging in the wake of 2008 Global financial crisis. Only few of the companies pioneered the neo banking model at that time rendering first digital banking services foregrounding transparency, ease of use along with avoiding huge fee structures of conventional banking (Schmidt-Jessa & Stradomski, 2023). In the mid 2010’s neo banks moved ahead highlighting their growth & expansion along with the advancement in technology & matured fintech ecosystems. During this phase neo banks shifted towards offer their full-service banking slightly moving towards providing seamless mobile/internet banking while addressing the needs of under banked or digitally savvy customers (PwC, 2016b; Edelman, 2010). In the late 2010’s neo banks got their regulatory recognition & expansion. Neo banks at this stage received their e-banking licenses in the developing countries UK, Germany, and Europe. The rise of different technology based regulations & software’s helped neo banks to deal with third party transactions & services increasing their appeal. In the start of early 2020’s neo banks gained substantial popularity as the digital banking was the mainstream at that time especially during the COVID-19 pandemic. Consumers got contactless financial services while dealing with other investments, crypto currency trading & other financial banking services declaring themselves as all in one digital only financial platforms (Horton and Strohm, 2023). In today’s current era neo banks have been going towards much mature policies & regulations focusing on revenue streams as well. These banks have begun diversifying revenue streams moving towards wealth management dealing with all sorts of traditional banking requirements. They are now focused on expanding globally & even traditional banks are helping them scale (Horton and Strohm, 2023). Overall, it is becoming increasingly tough for traditional banks to survive with their outdated systems & offer new fin tech based functions, products & services which will cope up the expectations of younger generations (Anagnostopoulos, 2018; Windasari et al., 2022). By the time lapse neo banks will continue to

evolve adopting changing to regulations, customer needs along with technological advancements while holding pivotal role in reshaping the global banking landscape.

The research would further lead to diagnose the role of Neo banks in the banking industry as per daily perspectives while keeping in mind the positive & negative consequences, risks & failures of neo banking as in collation to pre-existing traditional banks. This research would assist regarding explaining the involvement of technology in emergence of neo banks especially in Pakistan while keeping insight the ways of performing fintech transactions. Further it will clarify risk association & failure causes of neo banks in Pakistan along with dwarf analysis of financial literacy ratio in Pakistan. The research would further clarify the need of neo banking in particular society & especially a country like Pakistan while having in mind all above discussed factors. Moreover it would help the upcoming generation to know about the challenges, advantages, risks & other related factors of neo banks with the ways and solution to improve the neo banking role in the society & benefits for the tech savvy & other customers as well creating an ease for them & for the banking staff as well. The research would be restrictive in means of data collection as neo banking is not very much adapted yet in Pakistan although it will focus on all related factors regarding the neo banking industry in the country although questionnaire would be expanded to all targeted population & other secondary data would also be utilized as well in order to cope with data collection procedure. Moving ahead the research would enlighten the aspects of neo banking regarding main concerns especially in Pakistan. The targeted population would consist of mainly the professional bankers from different departments of different banks, some SME owners & individual customers who visit branch upon daily basis for their financial transaction slightly focusing upon the financial literacy rate in Pakistan as well using the convenient sampling techniques & a mixed method approach as well

### **The Growth and Impact of Neo Banks**

Technological advancements and increasing internet penetration have fueled the growth of Neo Banks. According to the Yield Report (2020), the rise of internet-based banking solutions has accelerated the adoption of digital-only banks. However, challenges persist, particularly regarding cyber security and fraud prevention. The Reserve Bank of India (RBI) reported financial fraud amounting to 604 billion Indian Rupees in 2022, emphasizing the potential risks associated with digital banking (Statista, 2022). Neo Banks operate on a business model centered around technology-driven financial innovation. The European Central Bank (ECB, 2018, p.3) categorizes Neo Banks as part of the broader financial technology ecosystem that enhances banking efficiency and accessibility. Given that Neo Banks are still in their early growth stages, they raise several regulatory and operational questions. Their reliance on FinTech solutions has played a significant role in transforming traditional banking processes and improving financial services.

Investments in FinTech have increased remarkably over the past decade. According to KPMG (2023), global FinTech investments reached \$226.5 billion across 7,385 deals in 2021, showing the rapid acceleration of technology-driven financial solutions. Neo Banks are at the forefront of this transformation, benefiting from increased consumer demand for digital banking services.

### **Disruption of Traditional Banking**

Neo Banks are redefining traditional banking by offering streamlined, user-friendly experiences through digital platforms. As of 2022, there were over 400 Neo Banks worldwide, reflecting the sector's continuous expansion and increasing customer reliance on digital banking (Statista, 2023). Unlike conventional banks that require a full banking license, Neo Banks often operate under different regulatory frameworks. While some acquire banking licenses, others collaborate with

licensed financial institutions to provide banking services (Naser, 2019). By leveraging cutting-edge technologies such as artificial intelligence, blockchain, and machine learning, Neo Banks offer lower fees, increased transparency, real-time transactions, personalized financial insights, and 24/7 accessibility. These features cater to tech-savvy customers who seek convenience and efficiency over traditional banking methods (Koen Meijer, 2021).

### **Historical Development of Neo Banks**

The idea of Neo Banks developed from the Global Financial Crisis of 2008 as financial challenges made weaker banking systems apparent, and the broken financial system and new banking rules made people look for better banking solutions (Schmidt Jessa & Stradomski 2023; Jessa & Stradomski, 2023). During the 2010s, Neo Banks developed their service areas. Companies use smartphones to enhance banking solutions and connect with financial technology systems. This period saw the integration. Our mobile banking apps target digitally savvy users with simple internet access (PwC, 2016b; Edelman, 2010).

During the 2010s, Neo Banks received regulatory approval mostly from European nations, including the United Kingdom and Germany, United Kingdom, Germany, and other European countries. Regulatory advancements enabled them. Neo banking companies started getting e-banking licenses, which made them more reliable to customers. Additionally, the new banking system helped Neo Banks partner with external service companies. The collaboration with external providers lets Neo Banks boost their range of services (Horton & Strohm 2023). In the first two decades of the 2020s Neo Banking experienced explosive growth because of the COVID-19 pandemic. The coronavirus pandemic required consumers to stay at home, and this drove many people to shift their financial activities online to digital banking solutions for contactless transactions, cryptocurrency trading, and investment services (Horton & Strohm, 2023). The new digital technology made Neo Banks complete online financial platforms capable of meeting diverse customer needs.

### **The Current and Future Landscape of Neo Banks**

Neo Banks continue to develop by concentrating on three key areas, which include revenue generation and wealth management and international growth and expansion. Traditional banks established strategic partnerships with digital-only banks because they realized that digital organizations bring superior competitive advantages. Traditional banking institutions have started forming enterprise cooperation deals with Neo Banks to boost their digital operations (Horton & Strohm, 2023). Traditional banks face important obstacles, particularly in their digital transformation. Traditional banks encounter problems because their systems and regulatory requirements are outdated (Anagnostopoulos 2018; Windasari et al 2022).

The fundamental needs for Neo Banks are data protection alongside compliance with governing rules as digital financial transactions force regulatory bodies to strengthen their customer protection guidelines and financial stability. The changing regulatory framework has a permanent impact on how Neo Banks will develop in the future. The development of Neo Banks leads to modifications in their operational systems and affects their business development plans. The global banking sector will experience transformative changes through Neo Banks, which will continue to evolve in their roles. These institutions will need to adjust their services in response to technological growth, together with shifting customer tastes. The integration of blockchain technology alongside artificial intelligence and real-time payment processing systems will drive the future of these platforms. The service capabilities of Neo Banks will be improved through enhanced services which will result in more efficient and secure digital banking.

The collapse of Neo Banks occurs mainly because of economic, political and regulatory and compliance risks. The global banking industry is transforming because of Neo Banks, which operate exclusively digitally. Various risk factors endanger the sustainability of Neo Banks, even though their operations remain stable. The combination of economic risks with political disruptions and regulatory requirements, and compliance obligations contributes to Neo Bank terminations. These risks significantly increase the failure rates of Neo Banks, mainly stemming from the ecosystem in emerging markets, especially Pakistan.

### **Main Hypothesis**

H<sub>1</sub>: A significant amount of Neo Bank failures occurs because of economic, political, regulatory, and compliance-related risks.

Sub-Hypotheses: (Based on Different Risk Factors)

H<sub>1</sub>: Economic risks significantly impact the failure of Neo Banks.

H<sub>2</sub>: Political risks significantly contribute to the failure of Neo Banks.

H<sub>3</sub>: Regulatory risks significantly influence the failure of Neo Banks.

H<sub>4</sub>: Compliance risks significantly affect the failure of Neo Banks.

### **Problem Statement**

The financial industry experienced a transformation via Neo Banks, which provides customers seamless, branchless banking services because of fintech innovations. The operational sustainability of Neo Banks remains unstable because of economic fluctuations, along with political risks and banking regulations and compliance standards. The operational success of these financial institutions in Pakistan's emerging markets gets seriously affected by these particular risks. The research investigates what factors lead to Neo Bank failures and presents methods for safeguarding their continued operation (Financial Times).

### **Research Questions**

Q1: How the economic risks contribute to the failure of Neo Banks?

Q2: What is the impact of political risks (e.g., government policies & political instability) on the sustainability of Neo Banks?

Q3: How do regulatory risks (e.g., licensing requirements & data protection laws) influence the failure rate of Neo Banks?

Q4: In what ways do compliance risks (e.g., fraud prevention, AML/KYC requirements, cyber security threats) affect Neo Banks' Survival?

Q5: How do these risk factors contribute collectively to the Neo Banks' Failures, and what strategies can be employed to mitigate these risks?

### **Literature Review**

“Neobanks” is an umbrella term used for digital-only banks, virtual banks, and challenger banks (Bhattacharjee et al., 2022). Neo Banks (Digital Only) is banks that offer all sorts of financial services without having the existence of a traditional physical branch. Customers' increasing need for ease in banking is anticipated to be a significant factor in neo-banking growth, which is expected to grow up to 53.4% in between 2020 and 2030 worldwide. (Grand View Research, 2022)

Neobanks are the possible and compatible future of traditional banking, as they would reduce the need for physical branches and compile them into different links and apps. Besides the rise of Neo Banks in a particular region or country, multiple possible factors may arise along with the adoption of Neo Banks, which would include none other than the associated risks & failure causes in a particular region, especially “Pakistan.

As technology in today’s world has grown much faster & is still growing at a very fast rate surely traditional banking will be overwhelmed by the technological era in the upcoming few years. Neo Banks are the most probable future of traditional banking if technological innovations are made from time to time in terms of the banking sector & they evolve eventually according to the requirements. However, the innovative nature of neo-bank technology also introduces new cyber risks that call for robust security measures. As reported by Fin News, neo-bank adoption rose 650% from 2017 to 2021. But a 2022 survey by FS-ISAC shows cyberattacks on financial institutions have also increased by 238% since 2018 (Partners Universal Innovative Research Publication (PUIRP) Volume: 01 Issue: 01 | September- October 2023 | [www.puirp.com](http://www.puirp.com)). This statement declares the risk along the rise of these banks as neo-banks possess expansive consumer data, including personally identifiable information, financial transactions, and account details prized by hackers and malicious actors. Experts note that neo banks present tempting targets due to their nascent security infrastructure compared to traditional banks. Industry analysis indicates key cyber risks surrounding neo banks include data breaches, identity theft, transaction fraud, denial-of-service attacks, and insider threats from employees or partners. Then in the same context, there is another point of matter; according to Sathye (1999) there is a significant contributing reason to customers' reluctance to use online banking which is a “poor level of awareness about the service”. Adoption and usage of Internet banking are significantly impacted favorably by awareness of its benefits and services (Azouzi, 2009).

These statements declare that along with the usage of Neo Banks, one as an individual should have proper knowledge regarding the proper ways to use it & how to benefit from it to cope with the risks & frauds associated with neo-banking. Besides these factors, social risks, financial risks, security risks, knowledge, and awareness are a few more risk pointers related to the risks of neo-banking (International Journal of Current Science Research and Review: Volume 07 Issue 06 June 2024). Furthermore, Anti-Money Laundering (AML) & Know your customer (KYC) factors are also important in the context of risks as these two factors are the main concern of traditional banking & they get hard to maintain when using neo-banking applications/sources (Beatrice Corander: Haaga-Helia University of Applied Sciences Bachelor’s Thesis 2021). Past literature has indicated a negative impact regarding risks (being dependent variable) upon the neo-banking industry in terms of technology usage & development while technology has also boosted up & overcome those risks from time to time but still, few gaps need to be covered up especially when we talk about a particular region/country which lacks the modern technology & where cyber breeches are way common & security levels are not up to the extent along with the existence & adaptation neo banking. The rise of neo banks, digital-only financial institutions, has brought innovation and convenience to the banking industry, but not without challenges. While these banks have disrupted traditional banking models, many have also faced significant hurdles that can lead to failure. Key factors include regulatory compliance issues, difficulties in achieving profitability, reliance on technology that can be vulnerable to security risks or operational failures, and intense competition from both traditional banks and fintech startups. Understanding these failure causes is essential to addressing the vulnerabilities that could hinder the long-term success of neo-banks.

Mainly the advancements in information technology (IT) have become an inseparable need for almost all corporate organizations, both government and private, which are instrumental in

providing support for increasing efficiency and effectiveness of performance and growth (De Haes et al., 2020). IT implementation by the company is successful when it is aligned properly and supports the company's vision, missions, and business goals. As IT risks on the neo bank applications, handling of IT problems along with the IT security services are still few of the main reasons due to which neo banking is facing failure issues especially in a country like Pakistan (ISACA, 2012a). Industry analysis indicates key cyber risks surrounding neo-banks include data breaches, identity theft, transaction fraud, denial-of-service attacks, and insider threats from employees or partners. Fin Tech's heavy utilization of artificial intelligence and big data analytics also raises concerns about data privacy, algorithmic bias, and regulatory compliance. These factors also play a role in leading causes of the failures of Neo Banks. (Partners Universal Innovative Research Publication PUIRP) Proper & right utilization of the updated technology is another leading cause heading towards the collapse of neo banks as not all population of any region is literate regarding the usage of advanced technology which leads them to report of multiple frauds & cyber breaches. Customer awareness regarding modern technology & their complaints resolving level is another key factor regarding this issue (Nithyakirrthy et al., 2024). Ineffective & outdated IT strategy usage by financial institutions sometimes leads to cybercrimes & becomes the failure cause of neo-banking (HCL 2021). Companies in the financial sector are more likely to be a target for cybercriminals than companies in other industries, the average annual cost of cybercrime for the banking industry in 2017 was 16,55 million US dollars and then rose to 18,37 million US dollars in 2018 (Accenture, 2019). This identifies the cost of dealing with cybercrimes due to the usage of old IT infrastructure & outdated technologies. As the technology is growing day by day so does the need for digitalization in banking industry rises.

According to (Grand view research, 2022) customer's enhancing need for ease in banking is anticipated to be a significant growth factor for neo banks which already has shown expected growth to 53.4% CAGR to its 2021 valuation of 47.39 billion in between 2022-2030. According to the study on cyber risks in neobanks have important findings. It shows that the level of cyber risks for neobanks is linked to the overall economic risk of a country. In countries with high cyber risks, neobanks also face high risks, while in countries with low cyber risks, neobanks experience low risks as well. This suggests that neobanks do not create new risks or worsen existing ones (Koibichuk et al., 2021).

The neo banking sector is relatively new and still developing. According to Accenture's Digital Banking Tracker, neobanks significantly increased their customer base, growing from 7.7 million in 2018 to nearly 20 million in 2019, representing a growth rate of 150%. This growth is much higher than the 2% for traditional challenger banks and 1% for established banks. However, there is considerable research focused on money laundering in digital banking. A search for "money laundering in digital banks" in the Scopus database revealed 27 studies conducted between 2017 and 2020 by researchers from 47 universities worldwide. Currently, there are many difficulties in evaluating the risks posed by businesses and individuals using neo banking services to launder money from illegal activities (Koibichuk et al., 2021). In his 2019 research, Advait Rao Palepu explored how capital investment affects the accessibility of Neo Banks. He also examined the restrictions set by the RBI on these banks. The author believes that Neo Banks are likely to succeed in India more than in other markets due to the growing demand for digital services. In 2015, McKinsey & Company released a report called "Digital Banking in Asia: What Do Consumers Really Want?" It surveyed about 16,000 banking customers in 13 Asian countries.

The results showed major changes in banking habits compared to 2011. In developed markets, almost everyone was using internet banking, and smartphone banking had increased more than three times. In emerging markets, about a quarter of consumers used computers and smartphones

for banking, indicating a strong shift toward digital banking across Asia. (Arushi Agrawal, Dr. Anuradha Yesugade, A perception study of Neo banking as a Fintech Revolution) Hossain and Rahman's article analyzes the growing influence of neo-banks on the banking sector through a customer survey assessing attitudes toward neo-banks compared to traditional banks. They provide an overview of the neo-banking landscape, highlighting business models and services that focus on convenience, transparency, and personalization. The study reveals that users think neo-banks offer better innovation and easy customer service. The article specifies security risks and regulatory hurdles that neo-banks face at present, and regulatory issues. The analysis shows that neo-banks will keep growing their business model in the future. Neo-banks now challenge established banks to change their business or risk losing market share. The banking industry now widely uses new information technology solutions. More people nowadays choose digital banks and neobanks which attract young urban customers as well as residents in remote areas. The fast rise of neo-banks brings increased interest from hackers looking for weak spots and potential vulnerabilities. Current banks employ open application programming interfaces (APIs) as part of their operations. Current systems help data sharing across different systems, but security weak points exist. Cybercriminals often aim to penetrate neobank networks to collect private information they can misuse or use themselves. To safeguard against both people from inside and outside a bank needs an entire security system. Our security plan guarantees smooth operations while processing huge data quantities at the top levels. A secure system defense plan must be built to protect against unauthorized access. Our security strategy depends on preventing unauthorized entry and deploying incident responses at once when security incidents strike. Our systems need quick error detection and recovery methods alongside rock-solid security measures. By implementing these appropriate protective steps, banks will enhance their data security elements without interrupting customer services will provide effective services to their customers. The future of Neo-banks will transform banking through their business approach. Digital-first financial institutions, named neo banks, now challenge traditional banking principles. Their survival depends on marketplace and social system forces which bring economic risks. political, regulatory, and compliance factors. Our analysis deeply reviews all these threatening factors. Our research takes current studies to understand why neobanks stop operating as successful companies.

### **Economic Risks and Neo-Bank Failure**

Economic stability helps neo-banks achieve business success. Studies confirm that Changes in national economic conditions, especially as they relate to increasing prices, GDP, and interest rates, strongly impact neo-bank performance. Research shows how overall economic conditions affect how banks operate, according to Koibichuk et al. (2021). In times of economic recession, when buyers cut their spending, the number of transactions and money-making opportunities drops for neo-banks for neo-banks. When neo-banks maintain thin capital reserves, they face greater chances of running out of available funds relative to traditional banks (IMF, 2022). Researchers found that developing markets face specific economic risks. The economic environment of Pakistan puts neo-banks at more danger of money loss when their currency falls in value and financial systems weaken. These markets experience more financial instability which creates challenges for digital banks (Palepu 2019). Research on European neo banks discovered that their dependence on transaction income creates economic challenges for their operations economic downturns. The revenue of these banks decreases when consumers spend less due to economic downturn streams directly, creating operational challenges

H1: Economic risks significantly impact the failure of Neo Banks.

### **Political Risks Impacting Neo-Banks**

Government management of financial services and political stability helps control neo-banking platforms. According to Agrawal and Yesugade (2021) sudden political changes in regulations impact how neo-banks operate. When national rules for fintech companies stay unclear neobanks need to avoid operations in these areas because they risk operational mishaps. Emerging markets face major political risks because fast-changing banking regulations and monetary policies can disrupt digital banking growth (McKinsey & Company, 2015). Government policies and political instability directly impact neo-bank survival rates. The controls that different countries set over foreign transactions pose serious obstacles for neo banks trying to work across borders in these regions. The latest political leadership can trigger unexpected policy changes that slow down fintech sector development. Neo banks running their operations in developing countries face larger risks because of political control over banking rules. Young financial companies in developing countries cannot develop operations or partnerships due to government rules.

H2: Political risks significantly contribute to the failure of Neo Banks.

### **Regulatory Risks and Licensing Challenges**

The regional regulatory systems control the procedures for neo-bank licensing while setting boundaries to their operational activities. In The leading developers of e-banking licenses in the UK along with Germany issue licenses to neo-banks. The e-banking licenses provided to neo-banks give them the ability to function like traditional banking institutions (Horton & Strohm, 2023). In developing countries Externally-managed arrangements are the only option for Pakistan neo-banks because regulatory issues restrict their market expansion. with conventional banks (Koibichuk et al., 2021). Compliance with Anti-Money Laundering Neo-bank operations face two major difficulties with Anti-Money Laundering (AML) and Know Your Customer (KYC) site requirements that impose strict processes and specifications for customer identification. The procedure for new customer enrollment and acquisition faces delays because of these requirements according to Beatrice Corander (2021). Neo banks experience their greatest threat from regulatory risks among all challenges they face. Governments and Financial institutions face severe challenges regarding AML (Anti-money laundering) and KYC (Know-your-customer) regulations established by regulators. Organizations need to meet international AML/KYC regulations that prove costly and complex to fulfill. Most neo banks do not adhere to changing regulatory regimes, resulting in fines, lawsuits, or revocation of licenses. Research shows that countries with strong regulatory systems, like Europe, have seen several neobank failures because of the failure to comply with regulatory requirements. Additionally, neo banks find it difficult to obtain banking licenses. In the United States, for instance, there is a need for a different banking license in each state, which complicates and makes regulation expensive.

H3: Regulatory risks significantly influence the failure of Neo Banks

### **Compliance Risks and Cyber security Threats**

Cyber security is a major issue for neo-banks, as they are dependent on digital platforms. According to a study conducted by FS-ISAC (2022), there was a 238% rise in cyber-attacks on financial institutions since 2018. Neo-banks, being digital-first in nature, are the most targeted by data breaches, identity theft, and online fraud (Partners Universal Innovative Research Publication, 2023). More research indicates that weak cybersecurity infrastructure and poor authentication methods render neo-banks susceptible to financial fraud (Sardar & Anjaria, 2023). Overcoming such compliance risks using effective encryption technology and compliance with regulatory requirements is vital to ensuring their viability. A prominent compliance problem is poor risk

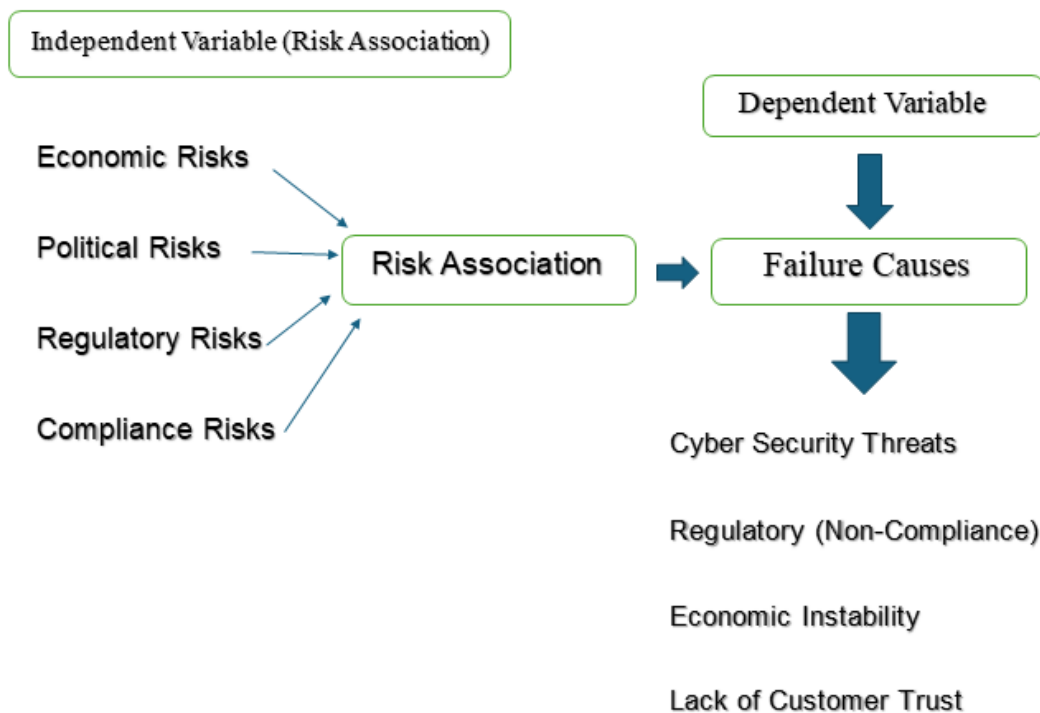
management models, which cannot identify fraudulent transactions. Neo banks that fail to invest sufficiently in cyber security and anti-fraud measures are more likely to suffer reputational loss and regulatory attention. Banks that began with neo technology need consumers to place their trust in their online operations. Research has A research study found banking customers trust traditional banks more than new banking providers because only 19% demonstrated faith in neo banks while 47% placed their trust in conventional banking services. conventional banks. Such distrust from clients primarily develops from compliance-related failures. Neo banks face problems when they fail to protect consumer data or do not establish clear dispute resolution procedures.

H4: Compliance risks significantly affect the failure of Neo Banks.

### **Mitigation Strategies and Future Outlook**

The reduction of neo-bank risks depends fully upon regulatory sandboxes, which experts within the industry identify as essential. The platform established by industry experts allows fintech companies to conduct controlled tests of their innovative solutions before full implementation. settings (Accenture, 2019). AI-based fraud detection systems need adaptation along with enhanced cybersecurity measures to strengthen fraud detection capabilities. Risks in management systems can be boosted by implementing cybersecurity measures (ISACA, 2012). Strategic Legacy banking institutions provide valuable benefits through regulatory support while offering its financial resources to help neo-banks grow sustainably. Neo-banks need financial security from partnerships to build sustainable growth (De Haes et al., 2020). Financial sector transformation through neo-banking requires immediate attention to new banking methods that lead to sustainable growth. For lasting success neo-banks need to control both economic and political risks as well as regulatory and compliance risk elements. This The research will perform an in-depth evaluation of these threat factors specifically within the Pakistani market framework. The research provides methods which strengthen neo-bank resilience and sustainability in emerging markets.

### **Conceptual Framework**



## **Methodology**

### **Research Design**

A primary quantitative research approach is the methodology to study the effects of risk factors on Neo Banks' failure. The research examines which types of risks affect the longevity of Neo Banks, specifically in developing market settings such as Pakistan. The study analyzes Neo Banks operating in unique regulatory environments of Pakistan and its equivalent emerging markets. The research employs descriptive and explanatory analysis techniques for statistical data evaluation. Through this methodology, researchers can obtain deeper insights about the operation. The study explores several risk components that affect operational challenges for Neo Banks as part of its deep analysis. The research gathers information from multiple professional groups. Professional members from banking, finance, fintech, IT, business management together with entrepreneurs and SME owners make up the study population. The participants of this research consist of both entrepreneurs who run SMEs also make financial decisions. The accessible participants necessitate using convenience sampling as the data collection method. The research includes 225 appropriate participants who form a representation for statistical analysis. The researcher obtains the primary data by using a prepared set of questions. The researcher designed a questionnaire by drawing from existing literature to assess how different factors affect Neo Bank failures. The study evaluates different risk elements that contribute to Neo Banks' operational failure. The individuals from the involved Department where they work will also evaluate Digital Banks (also known as Neo Banks) and identify potential risks within Neo Banks. The data collected was analyzed using Statistical Package for Social Sciences (SPSS) software. Descriptive Statistics served as the analysis tool for presenting an overview of frequency distributions combined with central tendencies of risk factors for neo-bank failures. Risk factors leading to neo-bank failure are studied through distribution and central tendencies and frequency analysis. The research investigates how risks distribute within operational and demographic groups according to Banna et al. (2024) and Kapoor et al. (2023) and Xu et al. (2022). The research employs Linear Regression Analysis together with Descriptive Statistics and Pearson's correlation test (Banna et al., 2024; Kapoor et al., 2023; Xu et al., 2022). The research demonstrates how economic risk, together with political risk and regulatory risk, along with compliance risk, functions to predict failure rates in neo-banking organizations. The testing method uses Pearson's correlation test to establish both the relationship power and connection direction between variables. This analysis reveals the main contributing risk elements through its study of correlation patterns between failure rates and risk factors (Hassan et al., 2023; Dermine, 2024; Vives, 2023). By leveraging these methods, the empirical data will reveal which essential risk aspects drive the unsuccessful termination of neo-banks through this investigation. The analysis provides critical knowledge for investors and banking strategists, together with regulatory institutions.

### **Data Analysis and Results**

This research examines the impact of risk factors (economic, political, regulatory, and compliance) on the failure of Neo Banks, particularly in Pakistan. The statistical tests conducted are Descriptive Statistics, Linear Regression, and Pearson Correlation to analyze the relationship between these risk factors and the sustainability of Neo Banks.

**Table1: Descriptive Statistics**

<b>Variable</b>	<b>Valid (N)</b>	<b>Missing</b>	<b>Most Frequent Values</b>	<b>Range</b>
Risk Association	214	11	44-56 (Highest:	15 - 75

			46 - 7.1%)	
Failure Causes	218	7	37-52 (Highest: 39 - 9.3%)	13 - 65

The data shows that Risk Association values range from 15 to 75, with the most frequent values between 44-56 (highest at 46 - 7.1%). Failure Causes range from 13 to 65, with the most frequent values between 37-52 (highest at 39 - 9.3%). The missing data (11 for Risk Association and 7 for Failure Causes) is minimal, ensuring reliable analysis.

**Table 2: Correlation Analysis**

Variables Compared	Pearson Correlation (r)	Significance (p-value)	Interpretation
Risk Association & Failure Causes	0.682	0.000	Strong positive correlation

The Pearson correlation coefficient ( $r = 0.682$ ,  $p = 0.000$ ) indicates a strong positive correlation between Risk Association and Failure Causes. This suggests that as Risk Association increases, Failure Causes also tend to rise significantly. The relationship is statistically significant at  $p < 0.01$ .

**Regression Analysis**

**Model Summary**

**Table 3:**

Model	R	R <sup>2</sup>	Adjusted R <sup>2</sup>	Std. Error of Estimate
1	0.682	0.465	0.462	7.36706

**Table 4: ANOVA Results**

Model	Sum of Squares	df	Mean Square	F	
Regression	9764.367	1	9764.367	179.910	0.000
Residual	11234.628	207	54.274	-	-
Total	20998.995	208	-	-	-

**Table 5: Regression Coefficients**

Predictor	Unstandardized Coefficient (B)	Standard Error	Standardized Coefficient (Beta)	t-value	Sig. (p-value)
Constant	10.669	2.444	-	4.365	0.000

Risk Association	0.647	0.048	0.682	13.413	0.000
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The model shows a moderate predictive power with an  $R^2$  value of 0.465, meaning 46.5% of the variation in Failure Causes can be explained by Risk Association. The regression coefficient ( $B = 0.647$ ,  $p = 0.000$ ) confirms that an increase in Risk Association leads to a significant rise in Failure Causes.

The ANOVA test ( $F = 179.910$ ,  $p = 0.000$ ) confirms that the regression model is statistically significant, indicating that Risk Association has a meaningful impact on predicting Failure Causes. The low standard error (7.36706) supports the model’s accuracy.

The constant value (10.669) suggests that even with no Risk Association, there are baseline Failure Causes. The coefficient (0.647,  $p = 0.000$ ) indicates that for each one-unit increase in Risk Association, Failure Causes increase by 0.647. This reinforces the strong link between the two variables.

**Table 6: Interpretation Summary**

Key Finding	Interpretation
Correlation (0.682, $p=0.000$ )	A strong positive correlation exists between Risk Association and Failure Causes.
$R^2 = 0.465$	Risk Association explains 46.5% of the variation in Failure Causes.
Regression Equation	Failure Causes = 10.669 + (0.647 × Risk Association)
Significance ( $p=0.000$ )	The model is statistically significant and can predict Failure Causes.

## Findings

The research on the collapse of Neo Banks indicates that economic, political, regulatory, and compliance risk factors are the determining factors in their viability. The descriptive statistics show risk association values between 15 and 75 with the most common values at 44 and 56, whereas failure causes vary from 13 to 65 with the most common values at 37 and 52. Correlation analysis defines strong positive correlation ( $r = 0.682$ ,  $p = 0.000$ ) between failure causes and risk association and therefore suggests that increasing risk factors is a significant contributor to failure levels. The regression analysis also confirms this conclusion, showing risk association accounts for 46.5% of the variance in failure causes ( $R^2 = 0.465$ ). The regression equation—Failure Causes = 10.669 + (0.647 × Risk Association)—indicates that for every unit rise in risk association, failure causes increase by 0.647 units. These findings affirm that regulatory restrictions, compliance risks, economic uncertainty, and political uncertainties altogether contribute to the collapse of Neo Banks. The research highlights the necessity for strong risk management measures to address these challenges and promote the long-term sustainability of Neo Banks, especially in developing markets such as Pakistan, where fintech penetration is subject to unique regulatory and economic challenges.

## **Discussion**

This study presents an analysis of research findings to illuminate the cause of neo-bank failure, particularly regarding Pakistan as an emerging market. Statistical testing showed that neo banks in Pakistan depend significantly on economic risks, along with political risks and compliance requirements, and regulatory conditions. The economic, political, regulatory, and compliance factors heavily affect the establishment of neo-banking institutions. The analysis reveals a direct link between risk association and failure causes, which shows through statistical results a strong positive correlation ( $r = 0.682$ ,  $p = 0.000$ ). The measurement indicates a strong positive relationship ( $r = 0.682$ ,  $p = 0.000$ ), showing risk elements lead to higher failure risks. The risk of failure rises in tandem with increased risk factors. Previous research findings match the current results. The advanced technologies of neo banks do not protect them from the regulatory obstacles that they face (Gomber et al., 2024; Koibichuk et al., 2021).

### **Economic Risks and Neo Bank Failures**

Financial instability stands as the primary factor that determines the feasibility of neo banks. Macroeconomic environmental elements that include inflation and changing interest rates and market volatility affect student confidence, and direct bank procedures suffer the impact of market uncertainty. In Pakistan, the Pakistani economic downturn forced digital banking to slow down because customer purchasing power decreased a combination of declining spending power and worsening financial abilities. Various research studies confirm that during economic slow periods, when economic recession sets in, consumers show stronger trust in traditional banks rather than neo banks. Customers choose conventional banks since they primarily need peace of mind regarding security protocols, as well as sufficient funds and government regulations (IMF, 2022).

### **Political Risks and Regulatory Constraints**

Financial instability stands as the primary factor which determines the feasibility of neo banks. Macroeconomic Environmental elements that include inflation and changing interest rates and market volatility produce Student confidence and direct bank procedures suffer the impact of market uncertainty. In Pakistan, The Pakistani economic downturn forced digital banking to slow down because customer purchasing power decreased. Poor economic conditions have caused both a decrease in purchasing power and declining financial knowledge among people. Various research studies confirm that during economic slow periods when economic recession sets in consumers show stronger trust in traditional banks rather than neo banks. Their primary concerns stem from security needs as well as regulatory compliance and liquidity matters (IMF, 2022). The challenge of meeting capital adequacy standards creates obstacles for neo banks during their operations vulnerable to a liquidity crisis. Neo banks differ from traditional banking institutions because they obtain funding from small financial buffers. The heavy financial reliance of neo banks on venture capital financing creates instability in their operation because this type of backing can prove unreliable in the future (Palepu, 2019).

### **Compliance Risks and Cyber security Threats**

Cyber security is increasingly a concern for neo banks because they are dependent on digital platforms. The increase in cyber-attacks on financial institutions emphasizes the requirement for robust security protocols. In line with FS-ISAC (2022), the cyber threats have risen by 238% to financial institutions since 2018. Neo banks, with their digital focus, are especially prone to data breach, identity theft, transaction fraud, and denial-of-service (DoS) attacks (Partners Universal Innovative Research Publication, 2023). Research indicates that poor cyber security infrastructure,

poor authentication protocols, and absence of regulatory control render neo banks an easy target for cybercriminals (Sardar & Anjaria, 2023). To address these risks, neo banks have to invest in sophisticated encryption technologies, AI-based fraud detection systems, and multi-layered authentication systems to protect customer information.

### **Impact of Customer Trust and Financial Literacy**

Customer trust and financial literacy are crucial for the adoption and success of neo banks. In emerging economies such as Pakistan, where digital banking adoption is in its infancy, low awareness and trust in online financial services are a major challenge. Research indicates that consumer hesitancy to adopt neo banks is mainly based on fears regarding cyber security, fraud threats, and the lack of physical bank outlets (Sathye, 1999). Moreover, most customers do not possess the technical skills needed to efficiently operate digital banking channels, leading to low adoption levels (Azouzi, 2009). To counteract these impediments, neo banks have to undertake educational programs aimed at increasing financial literacy and customer trust in online banking solutions.

### **Conclusion**

This study sheds light on the threats that undermine the sustainability of Neo Banks in developing markets like Pakistan. The information points out that these wholly digital banks face immense economic, political, regulatory, and compliance risks that lead to their failure. By conducting a quantitative study of responses provided by banking practitioners, fintech specialists, and customers, the research reveals a strong association ( $r = 0.682$ ,  $p = 0.000$ ) between risk perception and failure propensity. Furthermore, it is shown that 46.5% of the variation in failure causes ( $R^2 = 0.465$ ) can be accounted for by these risks through regression analysis. The report shows that even though Neo Banks features like better service delivery, low operational costs, and wider market reach are highly welcomed, banks have to manage these risks to survive. The research supplied empirical evidence to demonstrate the need for stronger regulatory compliance, better cyber security, and more complex business activity structures to counter these risks.

### **Recommendations and Future Implications**

To ensure the long-term viability of Neo Banks, the following strategies should be adopted:

#### **Strengthening Risk Management**

Neo Banks must develop robust risk management frameworks that include cyber security enhancements, fraud detection systems, and AI-driven risk analysis. Increased compliance with AML and KYC regulations is essential to maintain regulatory approval and consumer confidence.

#### **Regulatory Adaptation**

Governments should introduce regulatory sandboxes, allowing fintech startups to test innovative banking models without immediate compliance burdens. A balanced regulatory framework should be established to foster innovation while ensuring financial security.

#### **Enhancing Cybersecurity and Data Protection**

Neo Banks must invest in strong encryption technologies, two-factor authentication (2FA), and real-time fraud detection systems. Collaboration with cybersecurity firms and partnerships with regulatory agencies will enhance protection against cyber threats.

### **Improving Financial Literacy and Consumer Awareness**

Awareness campaigns should educate consumers about the benefits, risks, and security measures of digital banking. Simplified onboarding processes and user-friendly mobile banking applications will enhance adoption.

### **Diversification of Revenue Models**

Neo Banks must reduce dependence on transaction-based revenue and explore alternative income streams such as wealth management, digital lending, and business banking services. Strategic partnerships with traditional banks and fintech startups can provide financial stability.

### **Significance of the Study**

This research is important because it adds information on the major risk indicators pertaining to the failure of Neo Banks, especially in developing countries like Pakistan. Neo Banks provide a revolutionary approach to banking by offering financial and other traditional services via an online platform only. Unfortunately, these banks hide a lot of sustainability issues, for example, economic instability, regulatory limitations, compliance difficulties, and political risk factors. This research offers useful information on the sustainability issues of Neo Banks, presenting empirical evidence on how economic, political, regulatory, and compliance risks influence their viability. By recognizing and examining these risk factors, this study assists policymakers in crafting regulatory structures that promote digital banking development while maintaining financial security. The results will help financial regulatory authorities in framing guidelines that augment cybersecurity, strengthen consumer protection, and support fintech development. In emerging economies such as Pakistan, where digital banking is in its infancy, this research offers a platform for framing policies that promote innovation while effectively addressing risks. This research makes a critical contribution by examining the risk mitigation approaches employed by Neo Banks. Digital banking, being an emerging concept, has numerous core risks related to it that if understood, pose a great opportunity for financial institutions to develop comprehensive risk management frameworks. The study highlights fraud prevention, cybersecurity, and AML and KYC compliance as the most significant. Neo Banks can reduce the exposure to cyber threats and financial fraud while simultaneously increasing customer trust. The study also explains how AI and blockchain technology are enhancing the security measures of digital banking systems.

### **Limitations of the Study**

Several key factors contribute to this study's limitations. Firstly, the study is primarily focused on Pakistan, which restricts the generalizability of findings to other regions where Neo Banks operate under different economic, regulatory, and technological environments. Additionally, the research relies on a convenience sampling method, which may introduce selection bias and limit the representativeness of the sample. Another constraint is the reliance on self-reported data through questionnaires, which can be influenced by respondent bias or misinterpretation of questions. The study also primarily employs a quantitative approach, which, while valuable for statistical analysis, may overlook qualitative insights such as customer perceptions, operational challenges, and strategic responses of Neo Banks.

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