



University of St.Gallen

Module 7

N26 MOBILE BANK

Start-up und Growth of a Direct Bank

This case was collected and researched by Prof. Dr. Thomas Bieger and Dr. Simon Kuster.
It serves as a basis for the discussion of business issues in class and is not intended to
illustrate correct or wrong actions in management situations.

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Introduction

Valentin Stalf leans back in his chair in the N26 Berlin office in mid-May 2020. After a phase of hard lockdowns due to the first wave of the Covid-19 pandemic, the first re-openings are happening in Germany. Restaurants are slowly being put back into operation and the retail trade is also picking up. How would the crisis affect the payment behavior of the population in the long term? Will additional customers opt for his smartphone bank? Will the new customers generate sufficient income by regularly using the services of his online bank and also be convinced by additional value propositions such as insurance services?

Even during the lockdown in spring 2020, the fintech start-up N26 had managed to complete another financing round. On May 5th it was announced that the bank had raised 92 million euros in fresh capital¹. This provided the company with the necessary liquidity for further growth, which was particularly evident for internet-based services as a result of the Covid-19 pandemic. However, the general economic slowdown forced the company to be cautious and to make fundamental considerations: Should additional money be invested in the development of innovative services in order to reach new markets and target groups? Or should the money be invested in the optimization of business processes, in up- and cross-selling and thus in securing sufficient cash flows?

Becoming a founder

After graduating from high school in Vienna, Valentin Stalf moved to St. Gallen to study business administration, which he completed with a master's degree in accounting and finance. After his studies at the University of St. Gallen (HSG), he applied for various internships in investment banking, consulting, and auditing, although it was not easy to find a job just after the financial crisis of 2008. He finally received an offer at RocketInternet in Berlin, where he worked for one year. Even though Stalf did not see himself as an entrepreneur during his studies, he soon realized that he wanted to work in a growing industry.

Valentin Stalf's work at the start-up incubator RocketInternet was formative for him. There he saw how three people build a team of 80 people within a year and gain customers. The attitude of "just do it" impressed him. During his time at RocketInternet he also gained first insights into the business of startups in the field of payment systems such as Square or Stripe from the USA. Inspired by the founding spirit of the Berlin startup scene and fascinated by the disruptive potential of technological change in banking, Valentin Stalf decided to found a company with Maximilian Tayenthal, whom he had known for many years. The two complemented each other well. Maximilian Tayenthal's background in law provided valuable expertise in the area of regulation, which was essential for the necessary investor confidence, especially in the highly regulated financial industry.

The most valuable German fintech start-up

In 2013, Valentin Stalf and Maximilian Tayenthal were drafting the first concepts for a finance start-up in their hometown of Vienna, virtually working “in the garage”. However, they soon realized that they were dependent on a fertile ecosystem with access to technology, employees, investors, but also attractive first-time customers. At that time, they saw such an environment primarily in London and Berlin. Eventually, the founders got a place in an accelerator in Berlin and were able to secure an initial six-figure sum in financing from the Axel Springer Foundation. However, a new round of financing soon became necessary for the development, market readiness and initial growth. Angel investors committed about half a million euros to the venture. The so-called “Papayer” product at that time was aimed at a market niche: It was a digital pocket money app with a prepaid credit card.

After about a year, at the end of January 2014, the company was at a crossroads. It became apparent that the earnings potential of the business model was limited and the pocket money app with its associated Mastercard debit was mainly used by parents instead of their children. The company had already used up 400,000 euros in funding and only had liquidity left for around two weeks of operation with the ten employees who worked there back then. Instead of giving up, higher goals were set, and new capital was acquired: The team was able to convince its investors that the company was capable of building a mobile bank for clients of all ages. Via another alumnus from his alma mater, the University of St. Gallen (HSG), Valentin Stalf and his co-founder reached the European venture capital investors EarlyBird and RedAlpine, from whom they received seed financing of 1.5 million euros for the relaunch of their company under the name of Number26, later abbreviated to N26.

After the successful pivot, further financing rounds followed soon. In the spring of 2015, the American venture capital fund ValarVentures invested 10 million euros; further financing rounds of over 100 million euros with the participation of Asian investors were successful between 2016 and 2019². Within just a few years, N26 had become the most valuable fintech in Germany, with a valuation of over 3 billion euros³. The investor Frank Thelen praised the then 33-year-old Valentin Stalf with his idea of a pan-European bank as early as 2018 as a visionary of the German start-up scene with an outstanding focus⁴. The company invested a great deal of money in marketing and international expansion, with N26 suffering a minor setback in the wake of the Brexit: In April 2020, the online bank had left the British market with its top dog Revolut, as an independent banking license would have become necessary⁵. In the beginning of 2020, N26 had around 5 million customers and 1000 employees in the European and the American markets⁶.

N26 as a mobile direct bank

Like other young financial services providers such as Revolut from the UK or Neon from Switzerland, N26 offers fully mobile banking services. All interactions take place without branches via a smartphone app. In order to provide comprehensive banking, these companies need a banking license. Today, Revolut operates with a Lithuanian license, which is valid for the entire EU. Neon works as a Swiss provider by relying on Hypothekarbank Lenzburg. N26 also started out with a partner bank, but now has its own full banking license, which allows the company to offer the entire range of services in the areas of payment, savings and investment. The mobile-first approach without expensive branches allows for low-cost products and a digital 24/7 experience. However, the high dependency on technology with a lack of personal service in case of incidents and breakdowns has led to some criticism in the past⁷.

Valentin Stalf always had the vision to develop an app that supports customers in their daily financial decisions and provides access to all financial and financial-related services with a standardized user interface. Accordingly, N26 is constantly integrating new products and services. Third party services are also included, for example in the area of foreign currency transactions or lending, whereby the user experience is always completely uniformly designed by N26. However, the core of N26's offering continues to be the clearly structured range of current accounts for private and business customers, which are offered with a payment card (Mastercard debit) and various extra services (see www.n26.com).

Economics between growth and cash flow

New financial services providers such as N26 are operating with scalable technology by relying on cloud solutions for data storage and operations. This keeps fixed costs low, as there is no need to maintain an expensive technological infrastructure with server farms. The challenge of the business is rather to achieve strong growth with the necessary investments in development and marketing on the one hand and to generate sufficient cash flow on the other. According to Stalf, investors and management at N26 have long focused primarily on growth. The return on investment of individual clients was not particularly relevant. The aim was to gain a critical market share and create network effects in the consolidating market.

As late as 2018, N26 generated an annual loss of 73 million euros while achieving revenues of around 44 million euros⁸. In 2018, approximately 27 million euros were spent on new customer acquisition, roughly the same amount as on employee remuneration⁹. According to Valentin Stalf, the focus from 2020 onwards was much more on profitability with corresponding key figures such as cash flow or the contribution margin of individual customers (or their so-called payback time). It is clear, however, that an online bank must expect longer payback periods than other internet start-ups. The consideration of the customer lifetime value is important as individual clients might just turn profitable after many years.

Current management challenges

In technology-oriented start-ups like N26, employees are of critical importance. Particularly in young companies, employees usually work independently in a goal-oriented manner. They are expected to solve problems that are new and tackle them in innovative ways. Stalf described the example of a trainee who successfully set up N26's call center in its early days – without ever having carried out such an operation. Today, the company, which has around 1000 employees, is managed according to the OKR principle (objectives and key results), which was made very popular by Google. The company and its employees set specific targets for every quarter, each with some defined core results. These are agreed with colleagues and managers and recorded, so that their achievement can be transparently reviewed afterwards. N26's leadership team meets weekly, and weekly standups are held with all teams to share issues with the entire organization. Communication is central, while the number of direct reports is kept to a minimum. Thus, usually only four people report to Valentin Stalf.

Until 2020, a culture of growth, innovation and integration of new services dominated the company. Growth was financed primarily by the acquired investor capital. Then a change from a growth model to a cash flow model came into focus. This meant that sufficient operating cash should be generated by the company itself to finance its operations and growth. As a result, N26 began to concentrate not only on the pure number of customers, but above all on active customers who are profitable for the company in the long term. On the revenue side, profitability can be increased, for example, by upselling to premium account packages including higher-value services.

For Valentin Stalf, the Covid-19 pandemic represents both opportunity and risks. On one hand, social distancing and home office led to an increasing demand for location-independent web-services such as those offered by smartphones banks. N26 was thus able to attract the attention of new target groups who had previously relied primarily on analogue banking. The activation of these segments, which often have high purchasing power, represents a great potential that could be exploited by further investments in growth. On the other hand, the restrictions on travel to and from abroad have significantly restricted freedom of consumption and movement, which has a strong impact on the number of card transactions in the domestic markets and abroad. In addition, the investment climate has deteriorated in view of the generally rising debt burden caused by the crisis. Investors are taking a more critical look at the burn rate and are focusing more strongly on generating cash flows and profitability.

APPENDIX

N26 offers current accounts for private and business customers (see www.n26.com). Each of these accounts is linked to a Mastercard debit card with various included services and insurance. The monthly basic fee depends on the selected package, although no monthly fees are charged for the basic product. N26 can nevertheless earn money even with the “free” product, as it benefits as the issuer of its Mastercard from so-called “interchange fees”, which are transferred to it by the acquirer, i.e. the bank of the merchant accepting the Mastercard at the point of sale (see figure; licensor in the example of N26 is the American Mastercard Incorporated).

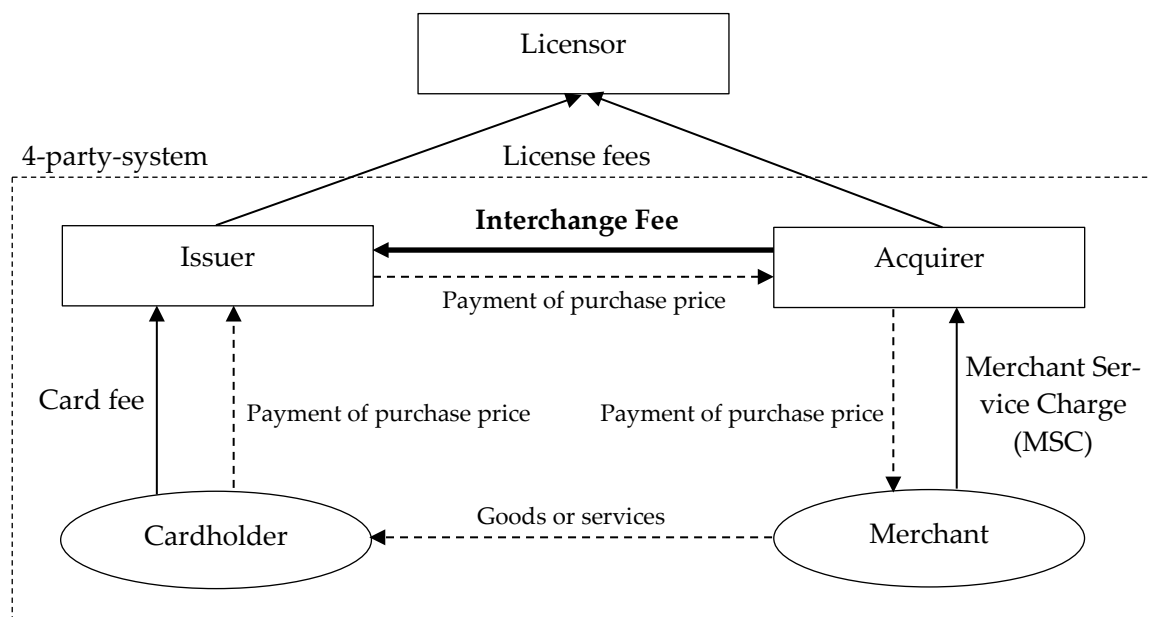


FIGURE: VALUE-ADDED SYSTEM OF PAYMENT CARD (SOURCE: COMCO, 2014)¹⁰

¹ Gründerszene, 2020: <https://www.gruenderszene.de/fintech/n26-92-millionen-investment>

² Crunchbase, 2020: <https://www.crunchbase.com/organization/n26#section-funding-rounds>

³ Handelsblatt, 2019: <https://www.handelsblatt.com/finanzen/banken-versicherungen/smartphonebank-3-1-milliarden-euro-n26-ist-jetzt-eines-der-wertvollsten-deutschen-start-ups/24670244.html>

⁴ Handelsblatt, 2018: <https://www.handelsblatt.com/unternehmen/management/menschen-des-jahres-2018/jungunternehmer-des-jahres-n26-gruender-valentin-stalf-auf-dem-weg-zur-banken-revolution/23750236.html>

⁵ FAZ, 2020: <https://www.faz.net/aktuell/wirtschaft/digitec/internetbank-n26-verlaesst-wegen-brexite-gross-britannien-16628701.html>

⁶ N26, 2020: <https://n26.com/en-ch/blog/5-million-announcement>

⁷ NZZ, 2020: <https://www.nzz.ch/finanzen/revolut-kunde-diese-antwort-ist-nutzlos-revolut-bot-es-freut-mich-dass-ich-dir-helfen-konnte-ich-wuensche-dir-einen-schoenen-tag-ld.1520915>

⁸ Finance Forward, 2020: <https://financelfwd.com/de/n26-bilanz/>

⁹ Gründerszene, 2020: <https://www.gruenderszene.de/fintech/n26-neue-geschaftszahlen-smartphone-bank>

¹⁰ COMCO, 2014: <https://www.news.admin.ch/newsd/message/attachments/37691.pdf>