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FINTECH AND THE DIGITALIZATION OF AUSTRIA'S BANKING SECTOR

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FINTECH AND THE DIGITALIZATION OF AUSTRIA'S BANKING SECTOR

SPECIAL REPORT

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Summary

Austria may have a relatively small fintech industry, but the Austrian government is making efforts to foster the growth of fintech and digitalization in the domestic banking sector. Fintech start-ups will benefit from favorable government policies, fintech events, and support funds; however, the increasing digitalization of the banking sector is likely to create risks for large banks that remain resistant to technological trends. Projections indicate that fintech and digital technologies will gain greater relevance in Austria in the next few years. Therefore, companies should integrate digital technologies in order to stay competitive. This GRI Special Report provides insight into the Austrian banking landscape, the extent of digitalization in the financial sector, and associated business risks and opportunities.

List of Abbreviations

| | |
|-------------------|---|
| <i>AI</i> | Artificial intelligence |
| <i>BMF</i> | Ministry of Finance (Bundesministerium für Finanzen) |
| <i>ECB</i> | European Central Bank |
| <i>FCA</i> | Financial Conduct Authority |
| <i>FMA</i> | Financial Market Authority |
| <i>IMF</i> | International Monetary Fund |

TAGS: AUSTRIA, FINTECH, BANKING SECTOR, DIGITALIZATION, REGULATORY SANDBOX, COMPLIANCE, BUSINESS STRATEGY, BUSINESS MODELS, INVESTMENT STRATEGY, START-UPS.

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Introduction: Status Quo and Development

Austria is a small Central European country bordering Germany and Italy with a population of 8.9 million inhabitants.¹ In recent years, the country has begun adopting emerging technologies in order to transform its banking sector and keep pace with global trends. Austria's financial digitalization creates not only risks but also opportunities for business investment and development.

Austria's financial market authority (FMA) released a study in June 2019 revealing that Austrian financial firms tend to adopt a positive attitude towards the digitalization of the financial sector.² While many view the digital transition as an opportunity to develop their businesses, roughly a fifth of all financial firms have not yet integrated current digital technologies into their business strategies. Chairmen of the FMA, Helmut Ettl and Klaus Kumpfmüller, stressed that Austrian companies must move away from the status quo and keep up with the growing international competition in the digitalized financial market.³ As innovations permeate banking sectors across the globe, Austria must establish itself as a leader in fintech, or financial technology, in order to attract the growing number of customers who prefer to manage their finances on their smartphones or on other technological devices.

Banking authorities in Austria have made efforts in recent years to shift professional and public attention towards digital innovations in the banking sector. On January 28-29, 2019, the International Monetary Fund (IMF) and the World Bank held a conference in Austria's capital, Vienna, where they presented the 2018 Bali Fintech Agenda. Representatives highlighted "key issues for policymakers and the international community to consider as individual countries formulate their policy approaches"⁴ to match the rapid developments in fintech. Additionally, the Austrian Banking

¹ Statista (2019): *Bevölkerung von Österreich von 2009 bis 2019*. Available at: <https://de.statista.com/statistik/daten/studie/19292/umfrage/gesamtbevoelkerung-in-oesterreich/> (Accessed: October 13, 2019).

² Financial Market Authority [FMA] (2019): *Digitalisierung am österreichischen Finanzmarkt*. Available at: <https://www.fma.gv.at/digitalisierung-am-oesterreichischen-finanzmarkt/> (Accessed: October 11, 2019).

³ Ibid.

⁴ International Monetary Fund [IMF] (2018): *The Bali Fintech Agenda*. Available at: <https://www.imf.org/en/Publications/Policy-Papers/Issues/2018/10/11/pp101118-bali-fintech-agenda> (Accessed: October 11, 2019).

Federation (österreichischer Bankenverband) and the Vienna Agency for the Economy (Wirtschaftsagentur Wien) initiated the annual event "Fintech Week Vienna" in order to strengthen the domestic fintech scene by exhibiting the latest technological developments in the banking, insurance, and legal sector.⁵

While Austria may not be a clear leader in the fintech revolution, its effort to transform its financial landscape through events and international initiatives has the potential to create opportunities for domestic and international stakeholders.

A Profile of the Austrian Banking Sector

Large Austrian banks have recovered since the global financial crisis in 2008, yet they still face several risks. First, low-interest rates have posed a challenge to the banking sector despite its post-crisis stabilization. This is not limited to Austria, as European commercial banks more broadly are also struggling with negative interest rates. European banks trailed behind US banks in terms of revenue in fiscal year 2018.⁶ Furthermore, the European Central Bank noted that low interest rates put European banks, insurance companies, and pension funds under pressure, posing risks to the longevity of their business models.⁷ Austrian financial institutions with a large customer base dealing with credit and deposit business are most affected by these low interest rates.⁸

Second, competition among commercial banks has transformed significantly since the advent of fintech. Large banks such as Erste Bank Group or Raiffeisen have promoted their online banking platforms in order to become more competitive. In 2015, Erste Bank Group introduced its banking platform "George," which has gained more than 5 million customers in 2019, making it one of the

⁵ *Fintech Week Vienna 2019*, homepage. Available at: <https://fintechweek.at/> (Accessed: October 11, 2019).

⁶ Allner, C. (2019): Österreichs Bankensektor im Umbruch: digital statt regional, *Der Standard*. Available at: <https://www.derstandard.at/story/2000097971013/oesterreichs-bankensektor-im-umbruch-digital-statt-regional> (Accessed: October 11, 2019).

⁷ European Central Bank [ECB] (2016): *Jahresbericht 2016*. Available at: <https://www.ecb.europa.eu/pub/pdf/annrep/ar2016de.pdf> (Accessed: October 13, 2019).

⁸ Allner, C. (2019): Österreichs Bankensektor im Umbruch: digital statt regional, *Der Standard*. Available at: <https://www.derstandard.at/story/2000097971013/oesterreichs-bankensektor-im-umbruch-digital-statt-regional> (Accessed: October 11, 2019).

largest Pan-European banking platforms according to representatives of Erste Bank.⁹ Following digitalization trends, competitor Raiffeisen launched a campaign to promote its “Mein ELBA” (My ELBA) online banking platform in June 2019, which aimed to attract customers with individualized application design and improved consulting services.¹⁰

Through the digitalization of the banking sector, smaller Austrian commercial banks now have the opportunity to implement new technologies and outpace large banks. While large banks adopt fintech relatively slowly, mainly focusing on online banking, smaller businesses have begun exploring opportunities such as live online consulting services, machine learning-based investment strategies, online credit applications, and other digitalized services that have the potential to replace an in-person visit to a bank branch. This agility of smaller financial institutions poses a threat to large banks that resist digital trends. The fact that an increasing number of large banks are closing branches and reducing the number of employees as financial digitalization advances may also be viewed as a central issue. Therefore, large banks must reassess their business outlook and strategy in order to mitigate this risk.

Fintech Start-Ups and Business Opportunities

Fintech in Austria is relatively new. In summer 2018, the Austrian FMA granted a license to a fintech firm – Finabro – for the first time.¹¹ Finabro offers products related to financial investment, savings, retirement planning, and company pension schemes. Fintech start-ups are competitive because not only do they provide these services to private investors but also because they can help

⁹ Austrian Press Agency [APA] (2019): 200 Jahre Erste Bank: 200 Jahre Zugang zu Wohlstand für alle, APA. Available at: https://www.ots.at/presseaussendung/OTS_20191006_OTS0019/200-jahre-erste-bank-200-jahre-zugang-zu-wohlstand-fuer-alle-bild (Accessed: October 13, 2019).

¹⁰ Futurezone (2019): Raiffeisen bringt neue Mein ELBA-App mit innovativer push-TAN-Technologie, Futurezone. Available at: <https://futurezone.at/apps/raiffeisen-bringt-neue-mein-elba-app-und-schafft-smstan-ab/400517218> (Accessed: October 13, 2019).

¹¹ Die Presse (2018): Zum ersten Mal erhält ein FinTech in Österreich eine FMA-Lizenz, Die Presse. Available at: <https://www.diepresse.com/5441741/zum-ersten-mal-erhalt-ein-fintech-in-osterreich-eine-fma-lizenz> (Accessed: October 11, 2019).

customers create portfolios. Lending has proven to be another worthwhile fintech opportunity, as microloans and peer-to-peer lending are also popular financial services.¹²

Fintech start-ups seizing these opportunities in Austria include N26 (originally Number26), Conda, Finnest, and Wikifolio. Furthermore, microloans are processed online by fintech companies like Cashpresso and Cashper. One of the most successful fintech start-ups in Austria is N26, which was established in 2013 and offers smartphone-based banking services. The company gained 1.5 million customers in October 2018 and became a fintech unicorn (a private start-up business valued at over \$ 1 billion) valued at \$ 2.7 billion in January 2019.¹³ Building on these successes, N26 seeks to expand further in Switzerland.¹⁴ A major advantage for fintech firms like N26 is that they save capital since they rely so much on technology that they do not have to employ as many people as traditional banks.

What these companies have in common in terms of market strategy is that they are all competing against larger, more established banks. Reaching a broad mass of consumers in order to establish themselves on the market is another common objective of start-up fintech companies. Offsetting these challenges is the fact that smaller fintech companies can be more dynamic than large banks, seeking market niches and adapting quickly to new technological trends. Central technologies shaping the fintech market are artificial intelligence (AI), clouds, blockchain, and biometry. These technologies permit the automation of tasks in various fields, including data, product, and risk management, and also make working conditions more flexible (e.g. remote work).

¹² Allner, C. (2019): Österreichs Bankensektor im Umbruch: digital statt regional, *Der Standard*. Available at: <https://www.derstandard.at/story/2000097971013/oesterreichs-bankensektor-im-umbruch-digital-statt-regional> (Accessed: October 11, 2019).

¹³ Allner, C. (2019): Österreichs Fintechs im Aufwind, *Der Standard*. Available at: <https://www.derstandard.at/story/2000095045754/oesterreichs-fintechs-im-aufwind> (Accessed: October 11, 2019); Jilch, N. (2019): Handybank N26 schafft den Sprung zum Einhorn, *Die Presse*. Available at: <https://www.diepresse.com/5558836/handybank-n26-schafft-den-sprung-zum-einhorn> (Accessed: October 11, 2019).

¹⁴ Allner, C. (2019): Österreichs Fintechs im Aufwind, *Der Standard*. Available at: <https://www.derstandard.at/story/2000095045754/oesterreichs-fintechs-im-aufwind> (Accessed: October 11, 2019).

The Extent of Digitalization in Austria

While Austria is not a leader in the adoption of cutting-edge fintech, digital technologies are increasingly relevant in the business world. According to a survey by data and statistics platform Statista on how businesses view digitalization in Austria, 61% of respondents regard the digitalization of the economy as an opportunity for growth.¹⁵ Austrian businesses and industries, however, utilize modern technologies to varying degrees. The Sales and Marketing industry has advanced the most, with approximately 50% of all companies offering online platforms for customers and 39% providing smartphone apps. Insurance companies are leaders in their approach to communication with customers. 70% of all insurance companies offer customer service through social media platforms.¹⁶

The banking sector is projected to experience a digital expansion as well. The number of private customers using the internet and smartphone apps to access their bank account is expected to grow, and the number of financial institutions employing digital technologies will increase accordingly.¹⁷ In 2019, 48% of all Austrian financial institutions used cloud systems to provide IT infrastructure and services. This ratio is expected to increase to roughly 66% by 2021. Banks and insurance companies will use complex data analysis programs most frequently. 55% of banks and 46% of insurance companies will employ machine learning in their business operations within the next two years. The fintech sector can be viewed as the most progressive in its adoption of new technologies. Fintech businesses utilize automated consulting services, so-called Robo Advisers, most frequently.¹⁸ Thus far, however, the FMA has concluded that the use of blockchain technology and AI is very limited in Austria.¹⁹

¹⁵ Wöhrmann, U. (2019): Statistiken zu FinTech in Österreich, *Statista*. Available at: <https://de.statista.com/themen/3929/fintech-in-oesterreich/> (Accessed: October 11, 2019).

¹⁶ Financial Market Authority [FMA] (2019): *Digitalisierung am österreichischen Finanzmarkt*. Available at: <https://www.fma.gv.at/digitalisierung-am-oesterreichischen-finanzmarkt/> (Accessed: October 11, 2019).

¹⁷ Wöhrmann, U. (2019): Statistiken zu FinTech in Österreich, *Statista*. Available at: <https://de.statista.com/themen/3929/fintech-in-oesterreich/> (Accessed: October 11, 2019).

¹⁸ Financial Market Authority [FMA] (2019): *Digitalisierung am österreichischen Finanzmarkt*. Available at: <https://www.fma.gv.at/digitalisierung-am-oesterreichischen-finanzmarkt/> (Accessed: October 11, 2019).

¹⁹ Ibid.

Growth of the Austrian Fintech Market

Future outlooks for the fintech market in Austria promise growth. Statista forecasts positive development in all four segments of the fintech market – digital payments, personal finance, alternative lending, and alternative financing. The volume of transactions is estimated to increase over the next years as follows:²⁰

| | 2019 | 2023 |
|------------------------------|---|---|
| Digital Payments | € 12.8 billion (\$ 14.1 billion) | € 16.31 billion (\$ 18 billion) |
| Personal Finance | € 1.22 billion (\$ 1.4 billion) | € 2.49 billion (\$ 2.8 billion) |
| Alternative Lending | € 22.68 million (\$ 25 million) | € 38.5 million (\$ 42.5 million) |
| Alternative Financing | € 47.96 million (\$ 53 million) | € 85.83 million (\$ 95 million) |

The digital payments and personal finance segments will expand the most by 2023, with personal finance transactions doubling and digital payments growing by the largest total sum, increasing by € 3.51 billion (\$ 3.9 billion).

New Business Models

The emergence of fintech has compelled banks to revise their business models, as it has given rise to new concepts such as the “platform bank,” the “data vault bank,” the “invisible bank,” and the “ecosystem bank.”²¹ The model of the platform bank is based on the development of a new digital platform. The data vault bank focuses on storing and protecting the personal data of customers. The invisible bank utilizes digital technologies to offer automated financial services. Finally, the

²⁰ Wöhrmann, U. (2019): Statistiken zu FinTech in Österreich, *Statista*. Available at: <https://de.statista.com/themen/3929/fintech-in-oesterreich/> (Accessed: October 11, 2019).

²¹ Chamber of Labor [Arbeiterkammer] (2018): *Digitalisierung in Banken*. Available at: <https://www.arbeiterkammer.at/banken> (Accessed: October 11, 2019).

ecosystem bank combines the aforementioned concepts to create new business models by, for instance, merging the benefits of digital platforms with data storage. The Austrian Chamber of Labor advises that banks should focus on the strengths of their respective business models in order to mitigate outsourcing or acquisition risks.²² Another crucial consideration in conceptualizing and implementing new business models is the question of how best to integrate digital technology and human responsibility. Issues regarding decision-making and legal responsibility in fintech must be established by legislators and policymakers as fintech advances in Austria.

Compliance: The Regulatory Sandbox

In order to foster the development of the Austrian fintech industry, the government has adopted a “regulatory sandbox” scheme. Regulatory sandboxes allow fintech companies to test and improve their innovative business models under the supervision of the FMA. The concept of the regulatory sandbox was created by the Financial Conduct Authority (FCA) of the United Kingdom. Austria received the support of an expert from the FCA when it adopted its own regulatory sandbox system.²³ The goal of the regulatory sandbox is to strike an optimal balance between regulatory control over new businesses and the promotion of innovation in fintech. The Austrian Ministry of Finance states that businesses must meet the following criteria in order to fall under the regulatory sandbox scheme:²⁴ 1) the business model of a company must be based on information and communications technology (e.g. blockchain), 2) companies must contribute to innovation in the Austrian financial market with their business models. Furthermore, already-established fintech companies can also access the regulatory sandbox if they collaborate with start-ups to test out new business models.²⁵

²² Chamber of Labor [Arbeiterkammer] (2018): *Digitalisierung in Banken*. Available at: <https://www.arbeiterkammer.at/banken> (Accessed: October 11, 2019).

²³ Ministry of Finance [BMF] (2019): *“Regulatory Sandbox” für FinTechs geht in Begutachtung*. Available at: <https://www.bmf.gv.at/presse/FinTech.html> (Accessed: October 11, 2019).

²⁴ Ibid.

²⁵ Ibid.

Government Support: Digitalization and the Job Market

In order to train professionals in adapting to technological changes, the Austrian government established two funds amounting to a total of €150 million (\$165 million). The “Qualification Fund for Employees” aims to support employees in staying current with digital developments. Since digital technology is a rapidly changing field in which knowledge can become outdated relatively quickly, professionals must stay well-informed about fintech and risk management strategies that integrate the latest market developments. The goal of “Project-Fund Work 4.0” is to create jobs and improve working conditions by, for example, introducing software that supports the needs of employees.²⁶ Supporting the job market and facilitating professional training in order to keep national unemployment rates low while also managing automatization and digitalization is crucial. It is likely that the number of employees in sales and customer service fields will decrease due to advancing digitalization trends. At the same time, the number of job opportunities is likely to grow in IT, data management, and product management.

Risks and Opportunities

The reduction of branches and personnel is a major risk for large banks as the digitalization of the banking sector advances. Smaller fintech companies put pressure on traditional banks to revise their business strategies and adopt new technologies in order to remain competitive. The FMA, however, also reports that a large number of Austrian financial institutions view the digitalization process as an opportunity to make their businesses more efficient and improve their services and communications with customers.²⁷ Data analysis, customer relationship management systems, and customer support through social media can make business operations more efficient, for instance.

A longer-term risk that banks in Austria could face is the imbalance in innovation between fintech start-ups and large, traditional banks. If these large banks do not review their business strategies to

²⁶ Ministry of Finance [BMF] (2019): “Regulatory Sandbox” für FinTechs geht in Begutachtung. Available at: <https://www.bmf.gv.at/presse/FinTech.html> (Accessed: October 11, 2019).

²⁷ Financial Market Authority [FMA] (2019): *Digitalisierung am österreichischen Finanzmarkt*. Available at: <https://www.fma.gv.at/digitalisierung-am-oesterreichischen-finanzmarkt/> (Accessed: October 11, 2019).

keep up with technological trends and consumer demands, they may have to acquire start-ups to gain fintech expertise. Buying fintech start-ups would likely be a costly investment. Therefore, large banks should use their resources to plan for future fintech strategies in advance.

Strategic Summary

Opportunities

- Austrian government authorities are making efforts to integrate digitalization in the domestic banking sector. This includes fintech events, support funds, and regulatory policies.
- Business operations are likely to become more efficient with the adoption of digital technologies in the Austrian banking sector.
- Customers can access financial services at any time and from any location by using new smartphone banking apps and social media-driven customer support.
- The number of consumers and businesses utilizing digital technology for financial services in Austria is expected to rise in the future, providing investment opportunities for companies.

Risks

- Large, traditional banks may be less agile than fintech start-ups in adopting new technologies and staying current with the latest technology trends.
- As digital technologies advance in the banking sector globally, Austrian consumers may also turn towards fintech start-ups for financial services instead of large banks that resist technological trends.

Tactical Breakdown

Operational

- Banks and financial institutions must revise their business models and adopt new strategies in order to retain competitiveness.
- Financial businesses must also invest in employing and training experts committed to staying up-to-date with fintech expertise.
- If large banks do not include digitalization in their long-term strategies, they may be required to purchase fintech start-ups in order to acquire technological knowhow.
- Although small fintech start-ups can be more agile, large banks, such as Erste Bank and Raiffeisen, have developed their own banking service platforms in order to enhance their attractiveness to customers.

Financial

- Austria's fintech industry is still nascent, but a range of fintech start-ups have proven popular in recent years. N26 is particularly attractive to customers and became a fintech unicorn in 2019.
- All segments of Austria's fintech sector – digital payments, personal finance, alternative lending, and alternative financing – are expected to grow by 2023.
- Austria's government established two funds totaling 150 million to support associated projects and employees.

Compliance

- Austria's government introduced its regulatory sandbox scheme in order to promote fintech innovation while still exerting regulatory control over fintech start-ups that are testing their business strategies.

Conclusion

While Austria's fintech sector is still emerging, it is expected to grow in the future. Smartphone banking apps are popular among customers in Austria, but more advanced technologies like blockchain and artificial intelligence are utilized to a very limited extent. Austrian consumers are slowly adapting to digitalization trends, with many using the internet for banking information purposes only. Digitalization may have to advance further in order to open up opportunities for more advanced technologies like blockchain and AI to gain popularity in the Austrian market. In an effort to foster the growth of the fintech industry, Austrian government authorities are introducing favorable policies and holding events such as Fintech Week Vienna. This can create an attractive environment for innovative fintech start-ups. At the same time, large, established banks may be challenged by ever-evolving technological trends. However, since digitalization is projected to increase in Austria, it can be concluded that large banks should adapt to these trends in order to remain competitive in the long-term.



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