Traditional Financial Service Providers and FinTechs: Cooperation or Competition?

Masterarbeit

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1 Introduction and Motivation

FinTech. This term combines *Financial Services* and *Technology* and "refers to industrial changes forged from the convergence of financial services and IT" by "using new technologies, such as mobile, social media, and IoT (Internet of Things)". [88, P. 1058] These innovative and technology-based non-banks are able to offer financial services not only in core banking activities such as lending, investment and payment but also in many other areas. Thus, the FinTechs' field of activity crosses the one of Traditional Financial Service Providers (TFSP) which causes an intensified competitive situation at the first glance.

Even though there already exist many studies on this relatively new research field, none of them answers the question conclusively how FinTechs and TFSPs interact with each other on the same market. Nitsch explains that the relationship between cooperation and competition of the two parties dynamically varies. Nevertheless, there is a recognizable trend that TFSPs strive for a cooperation by adopting the FinTech services in their product portfolios. [115, P. 11-12] Dorfleitner and Hornuf add that about 87% of the traditional banks they surveyed already cooperate with a FinTech start-up and plan to do so in the future. [52, P. 52] Drummer et al. state that there exists a competitive situation on the financial market which requires both TFSPs and FinTechs to decide whether they want to enter a cooperation, which kind of cooperation and with whom. Cooperation possibilities for this comprise a joint venture, corporate venture funds, incubators, a partnership based on a service provision, or the acqui-hire concept which is explained later. The authors add that some FinTech business models in Germany even depend on a cooperation with a TFSP for legal reasons.[53, P. 6] Even though there seems to be a tendency to cooperations between traditional and new financial service providers, the literature is not able to answer the question which types of FinTechs are rather suitable for a cooperation and which types rather compete with TFSPs. This paper addresses the research gap by considering different banking as well as FinTech business models in Germany. Based on the literature review of the FinTech business models as well as the case studies of six German FinTechs, the paper draws a conclusion to this main research question. These case studies additionally serve for the extension of the overall understanding for FinTechs in Germany. Therefore, they are the basis for the discussion of the second research question, the Critical Success Factors (CSF) of FinTechs in Germany, and the third research question, their chances and challenges on the German financial market. In all, this paper contributes to the identification of the role which FinTechs play in the German financial systems today and how this role might develop regarding their disruptive power and the different cooperation possibilities.

The remainder of this paper is structured as follows: The second chapter concentrates on the German banking system with its separation into three pillars and the analysis of its profitability. Considering the paper's focus on technologies in the financial sector, the banking system is discussed with regard to its digital progress and the development as well as adoption of technologies and innovations. The chapter closes with an overview of the problems in the shadow banking sector which simultaneously constitutes the transition to the third chapter and the main topic of this paper: FinTechs. After generally defining these types of companies and presenting an overview of FinTech concepts, the remainder of this paper solely focuses on German FinTechs. Thus, the German FinTech landscape with its hubs and international position is presented. The fourth chapter focuses on business models and starts with an overview of the existing business model research. This includes not only business model concepts but also business failure, technology acceptance and information system success models. Afterwards, banking business models as well as FinTech business models are discussed according to the Business Model Canvas (BMC) elements and with regards to the question whether and how they can cooperate. The fifth chapter is about business model analyses and presents different business model analysis methods in the beginning. Following this, the chapter can be divided in two main parts: The case studies analyze six different FinTech companies in tables using the Advantages, Benefits, Constraints and Disadvantages (ABCD) analysis method. This approach reveals not only the respective competitive or cooperative situation of the FinTech but it also serves for the derivation of its CSFs. These as well as the general chances and challenges of FinTechs in Germany are discussed following the analysis. The second part, the expert interviews, comprises 15 questions regarding the three mentioned research questions which are evaluated according to Mayring's qualitative content analysis. They serve for a verification as well as extension of the previous findings and contribute to the differentiation of FinTechs in different types. A conclusion including outlook in the last chapter completes the paper.

2 The German Banking System

In order to compare the FinTechs' products and services to the ones of traditional financial service providers, especially banks, the banking system with its advantages and challenges as well as its latest digital progress is considered.

2.1 Three-Pillar-System

The German banking system is a prototype of a bank-based financial system. [5, P. 3] Such

6 Conclusion and Outlook

The digital transformation has a high importance for the financial industry in Germany and is far-reaching, from customer products to background solutions. These products are user-friendly and individual as well as focus on the personalization, automation and facilitation of financial processes. Besides, their transmission to the customers is simpler and faster due to the use of the Internet and smartphones as distribution channels. While it is not clear whether the digitization created the FinTechs or whether the FinTechs arose from the digitization, they definitely accelerate the digital transformation of the financial industry. These start-up companies avoid physical branches and large operational infrastructures so that they can be characterized by their lean cost structures. Thus, FinTechs are able to offer cheaper products than TFSPs which is able to constitute a competitive advantage. Their innovative business models, compared to the ones of TFSPs, do not only differ regarding the cost structure but also regarding the revenue structure: FinTechs often focus on the creation of a dynamic growth instead of profits, independent of their business orientation. Since they are young companies with a small size and rather little staff, they often lack the attention by potential customers. In order to increase their name recognition, FinTech try to acquire as much customers as possible by offering them cheap or even free solutions at the expense of their profitability. While their specialization enables FinTechs to solve a specific problem and to develop unique products that differ from the ones of TFSPs, they can only serve a niche market. Even though their products are often intuitive and have a customer benefit orientation, their customer base is likely to be limited to early adopters and digital natives who are not affected by the overall low technology acceptance on the German financial market. While FinTechs, which need investments to scale their businesses, face an investment-hostile environment in Germany, especially among private investors, they benefit from the German start-up culture and ecosystem. Apart from the three main hubs, Berlin, Frankfurt (Main) and Munich, also other large German cities established a FinTech-friendly environment with premises, testing environments, access to customer data as well as the proximity to financial companies, universities, investors and mentors. In contrast to the TFSPs, FinTechs also benefit from development freedom without a fixed customer base, encrusted structures and large hierarchies. While FinTechs can simply develop new IT-systems, TFSPs have to change their established and partly obsolete systems without interrupting their main business.

Nevertheless, Germany has a bank-based financial system so that these banks have a high significance and a great importance on the financial digitization. Even though the development and establishment of new innovative products is complex due to the above mentioned obstacles, many German traditional banks start to engage in the digitization. While some develop their own mobile payment systems or robo advisors, the Deutsche Bank established an innovation lab to support the invention, creation, testing and implementation of own digital solutions. Both German big banks, the Deutsche Bank and the Commerzbank, also support the foundation and development of FinTechs by providing venture capital or incubators. This enables the TFSPs to participate in a digital solution without engaging in own development efforts and is therefore one possible cooperation between the two parties. While competing parties do not need any consent, a cooperation requires both, the FinTech and the TFSP, to reach an agreement. Thus, also two different views have to be considered: A FinTech can either focus on the end customer business and an independent business activity and might therefore avoid cooperating with a TFSP. Or it decides upon a cooperation. This can comprise selling the fully developed solution or the whole FinTech including its idea and staff to a TFSP. Besides, a cooperation exists when a FinTech receives financial support in the form of venture capital from a TFSP. A FinTech additionally benefits from avoiding complex and expensive regulation compliances in case a TFSP assumes specific operations such as its account management. Finally, FinTechs can enter into a partnership with TFSPs by selling them licenses which allow for the use of their product. The other way around, TFSPs can decide to compete with the FinTechs in their segment or to cooperate with them. Cooperation possibilities comprise the above mentioned acqui-hire concept and the purchase of the FinTech's product. Additionally, a TFSP can support the foundation and development of FinTechs by mentorships and the provision of incubators as well as accelerators in order to benefit from their solution in the future. In order to generate higher returns, TFSPs can also invest in promising FinTechs. Apart from joint venture with a FinTech, the TFSP can partner with it by paying the FinTech for integrating its product in the own product range. Finally, both can enter into a partnership which is based on the mutual integration of solutions without return services. However, a cooperation can only be achieved if both the FinTech and the TFSP have similar ideas and benefit from the conjunction. In order to answer the main research question of this paper, which types of FinTechs rather compete and which types rather cooperate with TFSPs, the German FinTech sector is divided in six segments based on the products they offer: payment, financing, asset management, insurances, intermediaries and supporters. The body of this paper then analyzes one German FinTech for each segment in a case study by employing the ABCD analysis method and expert interviews. While the ABCD analysis reveals that the six analyzed FinTechs all cooperate with one or more TFSPs, it was not able to comprehensively identify different FinTech types. While the expert interview analysis supports the assumption of a cooperation tendency, it was additionally able to divide the FinTech sector in three FinTech types concerning their ability and willingness to cooperate with TFSPs. The first type comprises those FinTechs which mainly offer a supportive and technology-based product. Even though these may be able to exist independently of TFSPs, they are often too small and too unknown to establish a customer base on their own. Since those FinTechs additionally often can be integrated easily into other systems, they are most likely to be purchased by TFSPs in the long run. FinTechs which fit in this category comprise kesh and gini which both developed a technological infrastructure, including an API, which supports banking processes. The second FinTech type includes those FinTechs which certainly focus on an end customer business and try to acquire the critical mass of customers to assert themselves as financial service providers. Even though they aim at capturing their own market, they often cooperate with TFSPs which assume certain core banking activities. auxmoney and ayondo, the two FinTechs which belong to this category, serve markets that have not been served before and thus established an own customer base. However, they avoid holding a banking license by assigning their account management to TFSPs. Finally, the third FinTech type encompasses those FinTechs which rely on the cooperation with different TFSPs. While smava, a comparison portal, is a typical example for this type, also friendsurance which supports the business of its partnering TFSPs and their customers is not able to operate without partnerships.

Since the FinTech movement is relatively new and the single companies only exist for several years, it is not yet assessable whether the FinTechs' relevance will increase or decrease in the long term. Besides, it cannot be predicted how fast and to what extent the digitization of TFSPs takes place in Germany. Nevertheless, the research in this paper suggests an increasing importance of cooperations between FinTechs and traditional companies at least in the near future. While most FinTechs seem to benefit from a cooperation in one way or another, the TFSPs can facilitate their digital transformation by cooperating with flexible and dynamic financial start-up companies.