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The rise and stall of Robinhood's addictive app

Robinhood is one of the pandemic's standout economic successes as locked-down Americans discovered trading on their phones – but the platform is facing a backlash.



Will Sartain, a student at Ohio State University, started trading stocks and options in February and now logs on to Robinhood regularly to check his holdings. **Bloomberg**

Annie Massa and Sarah Ponczek

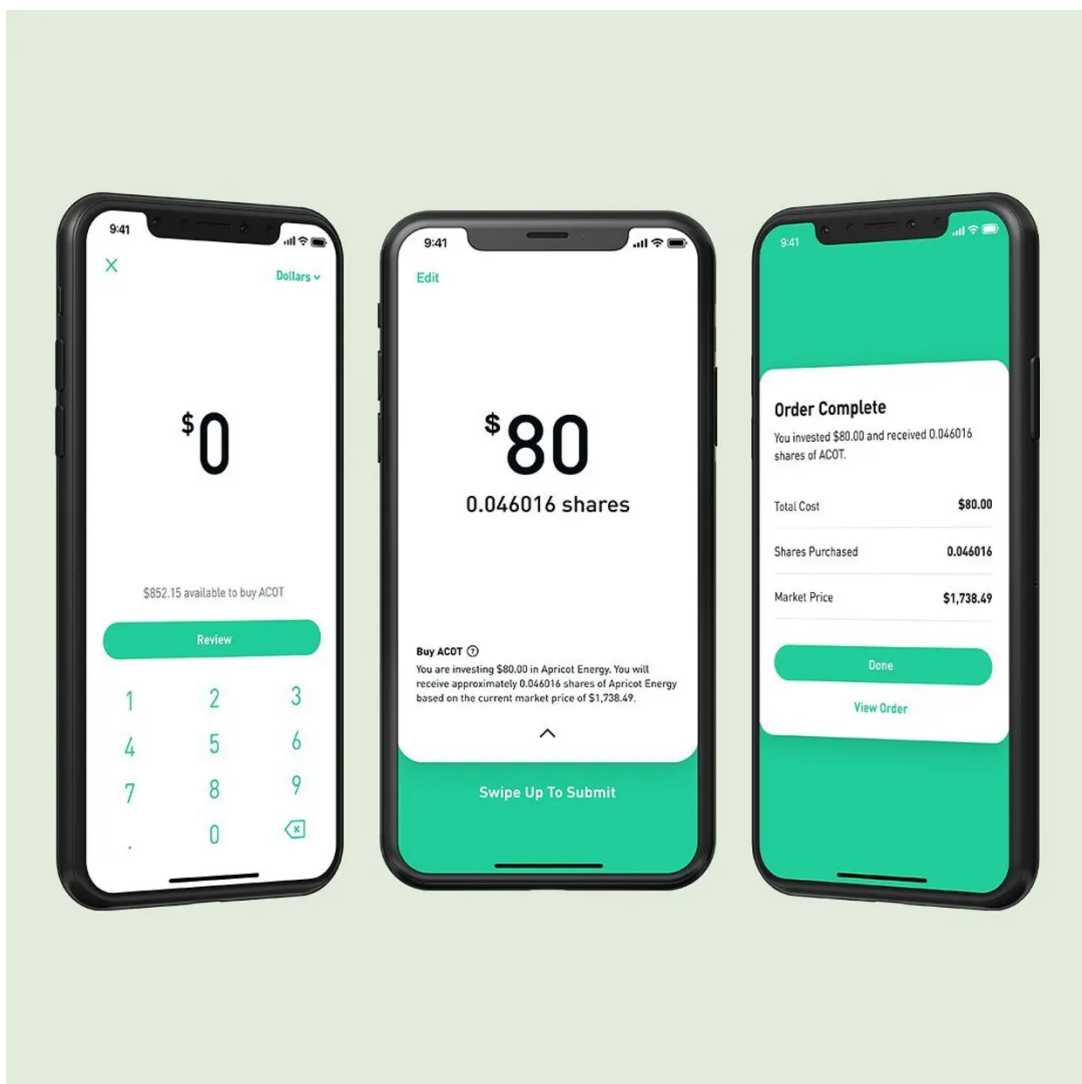
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On March 2, just before offices shut across the US, the staff at Robinhood Markets [<https://www.afr.com/markets/equity-markets/robinhood-blows-past-rivals-in-record-retail-trading-year-20200811-p55kgo>] worked long after sunset in their Menlo Park, California, headquarters.

Executives huddled around co-founder Vlad Tenev, then disbanded to bring orders back to their teams.

The company faced an emergency: a system-wide outage had disabled its online trading app throughout one of the sharemarket's busiest days in months.

Spooked by the early spread of COVID-19, US stocks had gone through a harrowing sell-off and then surged back. Robinhood's malfunction consigned its customers to the sidelines while more than 14 billion shares of US equities changed hands.



Robinhood's core product – stock trading on a fun game-like phone app – is both controversial and widely imitated.

Although Robinhood managed to restore the app's service, its handling of the episode angered customers and drew an inquiry from the US

Securities and Exchange Commission. (Both the regulator and Robinhood declined to comment on any investigations.)

The incident was the first tremor in what would become a prolonged period of turbulence for the online brokerage. It had several disruptions to trading and data from March through June, which sounds like a disaster for an upstart trying to draw customers away from Charles Schwab and ETrade Financial and to position itself as *the* money app for Millennials and Generation Z.

Founded in 2013, Robinhood courted long-ignored small-dollar and novice investors by charging zero commissions on trades.

But no: Robinhood would become one of the COVID economy's breakout successes. [<https://www.afr.com/markets/equity-markets/riding-the-robinhood-rally-20200527-p54x31>] Americans marooned at home binge-watched Netflix shows, went shopping on Amazon Prime, and discovered day trading on their mobile phones. “Robinhood traders” [<https://www.afr.com/markets/equity-markets/the-robinhood-army-is-here-to-show-fund-managers-how-it-s-done-20200731-p55hdv>] became the shorthand explanation for the frenzy of often speculative retail investing in the pandemic lockdowns.

It's the kind of moment when companies seize the chance to go big. For Robinhood, though, the most urgent need is to get it right – to prove it can manage a simple online trading platform and overcome a reputation for poor customer service. It's paused efforts to expand into Europe and Asia.

Instead, the company has been on a hiring spree for support staff and is focusing on making its technology more dependable.

“Over the next few months, you'll continue to see the results of all of that work that we've been putting in,” Tenev says in a video chat. He wears his hair shoulder-length, and like a lot of guys in these pandemic days, he's sporting some facial hair –in this case, a goatee. “There's a lot more coming.”

So what's Robinhood's next act? The core product – stock trading on a fun game-like phone app – is both controversial and widely imitated.

Founded in 2013, Robinhood courted long-ignored small-dollar and novice investors by charging zero commissions on trades. It later offered fractional stocks that allow people who can't afford, say, the almost \$US3,200 (\$4492) price of a single Amazon.com share to buy just a piece of one instead.

None of that's unusual any more: free trading is now the industry standard, and Schwab made "stock slices" available in June.

But free stock trading was supposed to be an entry point – not, by itself, the business that earned Robinhood a valuation of \$US11.7 billion in its most recent venture capital funding round.

Robinhood enticed big VC investors such as Sequoia Capital with the promise that "customers will grow with us," according to a 2019 pitch deck. In a slide that said "creating relationships to last generations", the company said each customer's value should increase over time. The first-time stock buyer can eventually graduate to using services the company has yet to offer, including individual retirement accounts, mortgage lending, car and rental insurance, and life insurance.

I would get a nice rush from sports betting. When I started putting the money into Robinhood, then I started feeling that same rush.

— Will Sartain, 19, Robinhood user

Robinhood could be under even more pressure to prove it can extend beyond free trades if it goes public. The company's unexpected growth this year has likely pulled the prospect of an initial public offering closer, though those plans aren't imminent, says a senior employee at one of Robinhood's VC backers, speaking on the condition of anonymity.

Tenev says he envisions Robinhood as a "large, independent public company" one day, without commenting on the timeline.

In a more tranquil market, it's easy to imagine a gradual transition from deep-discount sharebroker to financial supermarket for the mass affluent. (It's the path Schwab blazed decades ago.) But Robinhood has to show it can keep its burgeoning customer base happy even as it tries to coax it to the next level.

In attracting users, Robinhood has been incredibly effective. It has more than 13 million customers, 3 million of whom signed up in the first four months of the year. That's well above the 5.8 million retail accounts as of the end of June at ETrade, a company with an almost 40-year track record.

Robinhood's account balances are more modest than those at other large brokerages, says a person familiar with the company. In June it reported that average daily trades exceeded 4 million, blowing past all other brokerage rivals at a time when retail trading was booming.

Along the way, Robinhood has challenged industry conventions. It brought the compulsive, viral loops that govern our lives on Instagram and Twitter into the financial realm. The app is neatly in sync with Robinhood's mostly millennial-age customer base: About 80 per cent of its assets under management come from millennial users, the 2019 pitch deck says. Half of new Robinhood customers this year were first-time investors, the company said in May.

It's legalised gambling. Just like sports betting is entertainment, I think the stockmarket is entertainment.

— Dave Portnoy, Barstool sports founder

Will Sartain, 19, is part of Robinhood's fan base. His father tried to teach him about the sharemarket, but he never took much interest in it. That changed around late February, he says.

Sartain, a student at Ohio State University, normally spent about \$US50 (\$70) a week betting on football games, including his college team or the

New England Patriots. With live sports cancelled, he found himself enticed to trade shares and options.

Now he logs on to Robinhood about once or twice an hour when markets are open to check his holdings. “I would get a nice rush from sports betting,” Sartain says. “When I started putting the money into Robinhood, then I started feeling that same rush.”

Robinhood’s app emphasises social interaction by using the possibility of getting a free share of stock in exchange for inviting friends to sign up.

You have a tiny chance of snagging a high-price glamour stock such as Apple, Robinhood says, if your friend signs up and links a bank account. If you find your well of investment ideas running dry – or perhaps don’t know where to start – you can browse the 100 most-held stocks among fellow Robinhood users for inspiration.

Some of Robinhood’s explosive growth may derive from a sharemarket entertainment ecosystem that’s suddenly risen alongside it.

David Portnoy, founder of the website and podcast empire Barstool Sports, is perhaps the most notorious retail ringleader, pulling stunts like using Scrabble tiles to find stock tickers to invest in. He has no relationship with Robinhood, but they share a youthful audience with a taste for trading.

“Wall Street people don’t love this – it’s legalised gambling,” says Portnoy. “That’s really how I view it. Just like sports betting is entertainment, I think the stockmarket is entertainment. I don’t think there’s anything wrong with that.”

David Portnoy, founder of the website and podcast empire Barstool Sports, encourages his young audience to trade in the sharemarket. **Bloomberg**

A growing number of influencers on social media also promote Robinhood. TikTok videos under #robinhoodstocks have 8 million views. These include people such as Errol Coleman, who says he's been taking time off from Adams State University in Colorado since May to focus on investing. To his more than 200,000 TikTok followers and over 6000 YouTube subscribers, he offers explainers on everything from spotting a short squeeze to penny stocks.

Robinhood traders can, at times, move markets. They famously piled into Hertz Global Holdings in early June, and shares of the bankrupt car rental company began to surge. As trading volume in Hertz mushroomed, the number of Robinhood traders holding the stock swelled to 160,000 at one point – about 100,000 more than the month earlier.

It was crazy – shareholders of bankrupt companies generally get wiped out – but when the stock was trading for less than a dollar, maybe it was also fun for some traders to make a bet that things could hardly get any worse.

It's like playing poker – as long as you have a little money, you can sit down and start competing.

— Charles Rotblut, vice president for the American Association of Individual Investors

There's a very visible subset of Robinhood customers with a taste for risks once considered exotic. Options trading – in essence, a way to magnify both potential gains and losses on stock moves – exploded in popularity among smaller traders this year. Robinhood helped set the stage for that when it began offering free options trades in 2017.

Robinhood embraces the idea that investing should be accessible and, yes, thrilling. Its executives often deploy the Silicon Valley-ism that using their product should be “delightful,” a word not normally associated with securities investing.

Critics say Robinhood's app encourages users to see investing like a game. Investors are congratulated for their first trade with a confetti animation on their app.

“It's like playing poker – as long as you have a little money, you can sit down and start competing,” says Charles Rotblut, vice-president for the American Association of Individual Investors.

Academic research has shown that the more actively self-guided investors trade, the worse they tend to perform. Most of those studies were done before the death of brokerage commissions, a major drag on traders' performance.

But at the same time costs have fallen, markets have, if anything, gotten faster and more competitive. Anyone trading from a phone app is trying to outwit increasingly sophisticated pros on the other side of the bet. It's still not an even match-up.

Robinhood and its venture backers maintain that such worries are elitist. “There’s really a notion that it’s gambling or gaming if you’re new to the market, but it’s investing if you’re wealthy,” says Gretchen Howard, Robinhood’s chief operating officer.

Co-founders Tenev, 33, and Baiju Bhatt, 35, who met as students at Stanford, started out by working with big-money investors. Before creating Robinhood, they ran a hedge fund called Celeris, using high-frequency trading strategies, and a software company, Chronos Research, that catered to algorithmic traders.

While this seems a world away from Robinhood, high-speed trading firms are part of what makes free retail investing possible. A subset of these firms makes money essentially by processing brokerages’ trades, earning money on the tiny “spread” between the price an investor is willing to pay for a stock and the price someone will sell it for.

They earn enough that they’ll pay brokerages for sending trades their way, a practice known as payment for order flow. Hence, Robinhood was born with a built-in revenue stream.

Tenev and Bhatt hold weekly all-hands meetings where any Robinhood employee can ask questions about the company’s trajectory and business plan. In a recurring bit, one co-founder will ask the other for a refresher on Robinhood’s mission. The answer is always the same: making finance more accessible to all.

As is typical of Silicon Valley businesses, accessibility is tied to relying on technology, not human beings. The app provides no phone number for customer service. (It offered one years ago, but the number was removed, according to a person familiar with the business.)

The company boasted in its pitch deck that it had 23,700 customers per employee while Schwab had 595. It told prospective VC investors it would use “great product design” to achieve “viral adoption”, at a time when they were running a team of about 600 employees. Its approximately 1000-

person roster now is still lean compared with the more than 22,000 at Schwab, the industry's heavyweight with branches across the US.

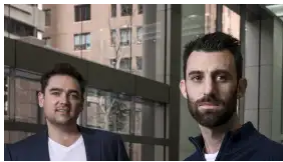
Thai Gaon made his first couple trades on Robinhood four years ago after a friend sent him a referral code to start an account and get a free share of stock. He resumed trading on it this year, and though he's a dedicated customer, he says "the customer service is totally awful".

Robinhood customers often complain that there's no one to call when the app is down or they have a question about their accounts.

Tenev says Robinhood has an "insane customer focus" and constantly reviews how it provides service. "Historically, we felt that the best way to provide our service at scale and to answer people's questions has been through email," Tenev says. "It's not a silver bullet to just add a phone number."

That attitude has caused some of Robinhood's biggest boosters to defect. J.J. Buckner, 29, runs a YouTube channel focused on investing, which he's turned into his full-time job since August. Viewership on his videos started to spike in March with titles including *My 28 Robinhood Dividend Stock Portfolio* and *5 Stocks I'm Buying During This Stock Market Crash*, getting tens of thousands of hits. He started selling mugs and hoodies emblazoned with the words "Drink Beer. Buy Stocks."

On October 14, Buckner announced he'd left the Robinhood platform and switched to Fidelity Investments. His main gripes: The customer service is poor, the app seems to go on the fritz a lot, and a recent hacking incident in which almost 2000 Robinhood accounts were compromised leaves him worried. "I will just sleep better at night knowing I have my account with a more reputable brokerage that has been doing this for a very long time," Buckner says.



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Robinhood says the hacking attacks were not a breach of its own system, but resulted from cyber criminals gaining access to customer emails affiliated with their Robinhood accounts. Victims vented on Twitter and LinkedIn, with some saying they didn't believe the problem was with their email.

Without an emergency phone number to call, they said, they were helpless as thousands of dollars disappeared from their accounts. "If we determine through our investigation that the customer has sustained losses because of unauthorised activity, we will compensate the customer fully for those losses," a Robinhood spokesperson says.

In the first half of 2020, US consumer protection agencies received more than 400 grievances about Robinhood, or about four times that of competitors such as Schwab and Fidelity. Frustrated customers fumed about outages and a lack of support. Robinhood responded by saying it had doubled its customer service staff and was hiring hundreds more, as well as improving the reliability of its platform.

A tragic incident earlier this year drew attention to some of the perils of introducing novices to complex markets. Alexander Kearns, 20, committed suicide in June [<https://www.afr.com/markets/equity-markets/the-lockdown-death-of-a-20-year-old-day-trader-20200705-p5594f>] after his Robinhood account showed a negative balance of more than \$US700,000, according to a series of tweets from his cousin-in-law Bill Brewster.

Alexander Kearns took his life when he thought he was more than \$US700,000 in debt following an option trade carried out on Robinhood.

In a note Kearns left, he said he had “no clue” what he was doing. Brewster said he believes Kearns only saw the losses on part of a multistep options trade but not the final outcome and misinterpreted what he owed.

In a statement, Tenev and Bhatt said they were “personally devastated” by what happened, and the company has made changes to its app to make options trading easier to understand.

Robinhood’s attempts to move beyond trading so far have been bumpy. Last year the company abruptly withdrew an application for a banking charter, which would have allowed it to provide its own debit cards and accounts insured by the Federal Deposit Insurance. It currently works with outside banks to provide a debit card and FDIC protections on its cash management product.

In 2018 the company botched the rollout of a different checking and savings product it was planning. It said the Securities Investor Protection would insure customers’ money. But the SIPC only protects assets in brokerage accounts in limited cases when a broker fails and doesn’t offer the kind of blanket protection against losses that bank customers are used to getting from the FDIC. The SIPC said Robinhood hadn’t contacted it before announcing the plan.

Tenev bristles at the notion his customers are all twitchy-thumbed day traders: “A very small percentage of our customers are engaging in day trading and active trading.” He says that lots of them are making recurring investments in the market, using fractional shares.

That points to an intriguing possibility. With zero commissions and the ability to buy tiny pieces of a stock, small investors could, in principle, use Robinhood and its imitators to build for themselves the kinds of low-cost, diversified portfolios they once had to get from fund companies such as Vanguard Group and BlackRock.

There’s certainly a market –and an audience – for that approach. Kamilah O’Brien, 40, runs a YouTube channel called Focused Spender, where she shares personal finance tips on topics such as saving for an emergency and getting out of debt.

But a video she made about investing \$US500 across several stocks in a Robinhood account is by far her most popular with 612,000 views. “I don’t

like to just do investing videos – but investing videos tend to do much better,” says O’Brien. “I have my initial investment with Robinhood, but I don’t go back and actively trade.”

Right now, trading is still important to Robinhood’s business model. Last year the company expected to make most of its revenue from sheer trading volume through payment for order flow, from which it anticipated receiving \$US180 million.

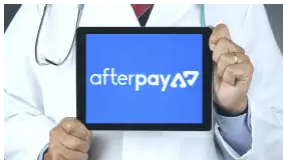
The practice is legal and common, but Robinhood didn’t widely publicise it until October 2018, days before Bloomberg News reported it as a significant revenue stream for the company. The SEC is now investigating Robinhood’s disclosures; the company declined to comment on the inquiry.



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Detractors say such payments raise conflict-of-interest issues by encouraging the routing of client orders to the trading firm that pays the most, rather than to the one that gets the best price. SEC rules require that brokers seek the best combination of price, speed and reliability.

Regulators already dinged Robinhood once on its practices around payment for order flow. The company agreed to pay a \$US1.25 million fine to settle charges with the Financial Industry Regulatory Authority, which oversees brokerage firms, for not being vigilant enough in ensuring customers were getting the best possible execution of equity orders for about a one-year period through November 2017 – an accusation Robinhood neither admitted nor denied. Robinhood says it never considers payment in deciding where to direct a trade.

As Robinhood seeks to convince its users that it can be more than just a trading app, it may face difficulties outgrowing its cowboy image. Mo Caletini, 32, deactivated his account after he landed a job as an assistant financial adviser at a large US bank, which doesn't allow him to use an outside broker.

He says he'd be glad to return, though he would be unlikely to use it for anything beyond trading. "Day trading is mostly what I want to use it for," he says. "Eventually, I would take whatever profits or proceeds to a more secure account."

Bloomberg Businessweek