

## **Stealing from the poor in the name of the empowerment**

### **RobinHood Markets**

RobinHood is the first company in the industry to introduce commission free trading available at the palm of your hand. Amidst ashes of the 2008's crisis, when the public frustration over the lack of sanctions for Wall Street was at the boiling point, the idea for the company was born.<sup>1</sup>

Startup was founded by two young entrepreneurs - Vladimir Tenev and Baiju Bhatt. Vladimir, born in Bulgaria, emigrated with his parents to the United States, when he was five years old. His parents, conveniently for his future career, worked for the World Bank, thus from a young age, Tenev was encouraged to work in the financial industry. Although, as he states "I didn't really grow up with entrepreneurship in mind."<sup>2</sup>, he got into Stanford College - the mecca for startup creators, where he majored in mathematics. On the campus he met his friend and business partner - Baiju. They had a lot in common, Bhatt was also a son of highly-educated immigrants that came to America looking for a better future, similarly had a great interest in economics and studied math<sup>3</sup>. As can be seen, they had the perfect foundation and conditions to start a financial startup, and so they did. In 2010 they started a company concerned with high-frequency trading, shortly after, they founded their next venture - Chronos Research which offered low-latency software for banks.<sup>4</sup>

While working closely with banks and brokers, Tenev and Bhatt noticed how expansive and inaccessible is the stock market for common people, especially for the younger part of the society. Very high execution fees and account minimums hindered access to the rich's playground considerably. Pair of Stanford grads became determined to change this with their newest business venture - RobinHood.<sup>5</sup> The idea was truly revolutionary in a way. They took the stock market, which was considered boring and mainly limited to the old and wealthy part of society, made access to it free, and focused mainly on the mobile.

Albeit today this may seem obvious, but back in April 2013, it was far from certain that mobile is going to conquer the world, especially if it comes to stock market solutions. It is easy to see how Facebook and Instagram influenced their idea. Similarly to the mentioned behemoths, Robin Hood was designed to be easy, addictive and simple to use, all with the focus of mobile.

After this brief analysis of Robin Hood's beginnings, it's not hard to proclaim that it was destined for success. Firstly, the creators had the perfect background for such a startup, secondly they were able to create a solution that their customers didn't know they needed - they showed the young and not oriented in finance that they can extremely easily

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<sup>1</sup><https://www.businessinsider.com/robinhood-app-vlad-tenev-founder-free-stock-trading-valuation-2017-7?IR=T>

<sup>2</sup><https://www.businessinsider.com/robinhood-app-vlad-tenev-founder-free-stock-trading-valuation-2017-7?IR=T>

<sup>3</sup><https://lithub.com/im-baiju-bhatt-robinhood-ceo-and-this-is-how-i-work-1797407595>

<sup>4</sup>[https://en.wikipedia.org/wiki/Vlad\\_Tenev](https://en.wikipedia.org/wiki/Vlad_Tenev)

<sup>5</sup><https://www.forbes.com/sites/halahtouryalai/2014/02/26/forget-10-trades-meet-robinhood-new-broker-age-targets-millennials-with-little-cash/>

try their luck in the stock market. What is also interesting, in the beginning they claimed not to have a clear way on how to make money from their services. It was suggested that RobinHood will soon enough introduce paid premium futures for more specialized investors. Albeit, without any problem, they were able to secure 3 millions in seed funding from venture capitals firms such as IT Ventures and GV<sup>6</sup>. Personally I don't believe in the story, that they planned for their business model to rely on premium futures as creators claimed in the first interviews. It was certain that the company would burn cash from the start - and in the end someone had to pay for the transaction order fees. It's highly unlikely that Bhatt and Tenet, with broad financial experience, wouldn't realize how much worth is the transaction flow and gathered data of retail investors. I would personally argue that from the very beginning of the company, investors (their gathered behavior and transaction flow) were supposed to be the product of Robin Hood.

Nevertheless, the company quickly exploded in popularity. Months before launch which occurred in March 2015, it gathered hundreds of thousands users registered in the waiting list, encouraged just with the perspective of easy and simple access to the stock exchange - all of this was done without a cent spent on marketing.<sup>7</sup> The app was spread by a word of mouth, which likely begun in the hackathon "LA Hacks" where it was presented for a first time<sup>8</sup>.

The app which gamified the stock market, spread like wildfire in a dry californian bush. In April 2017, Robinhood raised \$110 million at a \$1.3 billion valuation, just after 4 years since inception, and two years from official launch. The freemium business model proved unreliable, and the biggest and only viable source of revenue became payment for order flow from market makers - "compensation and benefit a brokerage firm receives for directing orders to different parties for trade execution."<sup>9</sup> In the Q1 of 2021 the PFOF accounted for more than 80% of the company revenue.<sup>10</sup> In 2018 the startup started experimenting with banking, to finally create a new future called "cash management", which allowed their users to hold passively their money with a competitive interest rate. The company failed to obtain a banking license, although it tried to do so.

Robinhood reported in May 2020 that it has secured \$280 million in venture capital at a pre-money valuation of \$8.3 billion. About one year later it IPOed under stock ticker "HOOD". The offering was bumpy in the beginning, but not long after the IPO, the company reached an all-time-high evaluation of 32 billions (10 billions currently due to recent market correction).<sup>11</sup>

The company states that its mission is to: "democratize finance for all"<sup>12</sup>, and it's hard to deny its influence in the process. They were first to introduce commission free trading, and also the first to offer usable mobile software for stock market access. Most of the company demographic belongs to millennial and Gen Z part of society, which for a long time was mostly ignored by older brokers. Robin Hood changed the game. Finally in 2020, it forced most other brokers to introduce their own trading free offers. Nowadays RobinHood isn't as outstanding as it was, but it certainly led the change.

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<sup>6</sup><https://craft.co/robinhood/funding-rounds>

<sup>7</sup><https://www.forbes.com/sites/jeffkaufman/2020/08/19/the-inside-story-of-robinhoods-billionaire-founders-option-kid-cowboys-and-the-wall-street-sharks-that-feed-on-them/>

<sup>8</sup>[https://en.wikipedia.org/wiki/Robinhood\\_Markets](https://en.wikipedia.org/wiki/Robinhood_Markets)

<sup>9</sup><https://www.investopedia.com/terms/p/paymentoforderflow.asp>

<sup>10</sup><https://www.investopedia.com/articles/active-trading/020515/how-robinhood-makes-money.asp>

<sup>11</sup><https://www.cnbc.com/2021/07/28/robinhood-valued-at-32-billion-after-selling-shares-in-ipo-at-38-per-share-source-says.html>

<sup>12</sup><https://robinhood.com/us/en/support/articles/our-mission/>

On the other hand, the venture gamified the stock market, allowing for the creation of gambling addiction in young adults. It seems the only way for the company to make profit was to sign contracts with market makers and hedge funds. The business model works, as the company can boast impressive gross margins<sup>13</sup>, but it bears extreme costs in public relations, as the people more and more realize that the service isn't truly free - most of the investors lose money to market makers - customers of Robin Hood. It doesn't help that, since 2019 the company constantly falls from one PR nightmare to another. The most notable one being the GME scandal, where Robin Hood banned investors from buying more GME stock, presumably to limit the losses of Melvin Capital and Citadel (Citadel being the biggest revenue stream for Robin Hood)<sup>14</sup>. It will be interesting to see if the company survives the scandals, now that the competition has started to offer similar solutions as them. Robin Hood has chosen hedge funds, over retail investors, will the customers forget or forgive? - that remains to be seen.

Robin Hood history and its business approach was truly remarkable, albeit not ethical. It clearly had all it need, to succeed but now it lacks a clear plan on how to survive and become a multi decade company. It can't be denied that success of the platform can be attributed in a large part to the experience, creativity and lead of its creators. It is a great example, from which I have learnt a lot.

Thank you for reading

### Lean Canvas of Robin Hood Markets

Second part of the table lies on the page below.

Problem	Solution	Unique value Proposition	Unfair advantage	Customer segments
<ul style="list-style-type: none"> <li>- high commission fees and accounts minimums</li> <li>- lack of mobile solutions</li> <li>- difficult and inaccessible way of accessing the stock market through current solutions</li> <li>- lack of source</li> </ul>	<ul style="list-style-type: none"> <li>- solution focused mainly on mobile</li> <li>- simple and intuitive app</li> <li>- easy and free access to stock exchange</li> </ul>	<ul style="list-style-type: none"> <li>- commission free trading of stocks and cryptocurrency</li> <li>- simple and mobile access to stock exchange for its users</li> <li>- "democratizing the access to financial markets"</li> <li>- access to extensive</li> </ul>	<ul style="list-style-type: none"> <li>- experienced in the field</li> <li>creators with connections</li> <li>- "first mover advantage"</li> <li>- support from Wall Street</li> </ul>	<ul style="list-style-type: none"> <li>- hedge funds</li> <li>- market makers</li> <li>- banks</li> <li>- high frequency trading firms</li> <li>- young and not wealthy part of society (millennials, gen Z)</li> <li>- cryptocurrency traders</li> <li>- students interested in financial</li> </ul>
	Key Metrics		Channels	
	<ul style="list-style-type: none"> <li>- number of users / investors</li> <li>- number of</li> </ul>		<ul style="list-style-type: none"> <li>- mobile application</li> <li>- website</li> <li>- API</li> </ul>	

<sup>13</sup><https://finance.yahoo.com/quote/HOOD/>

<sup>14</sup><https://cointelegraph.com/news/financial-ties-between-robinhood-and-funds-shorting-gme-falls-under-scrutiny>

of payment flow data	transaction made by the users - size of the transactions made by the users - variety of stock tickers and market products accessed by the users	behavioral data concerning retail traders and creation of payment flow data	- social media - email - customer support	markets
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Cost Structure	Revenue Streams (from most important to least)
- stock exchange transaction costs - server hosting hosting, IT architecture - highly educated workforce - law service fees in connection with the banking and brokerage regulations and regulators - marketing (marginal) and public relation - cyber security and safe data storage - fees for access to market data	- payment for order flow - sale of customers data - marginal lending - premium subscriptions - Robin Hood Gold - interest earned from users cash account reserves