Who Benefits from Innovations in Financial Technology? (Job Market Paper)

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Abstract

Financial technology affect both efficiency and equity in the stock-market. The impact is non-trivial because several key innovations have altered multiple dimensions of investors' opportunity sets at the same time. For example, better and faster computing has made it (1) cheaper for retail investors to participate, and (2) to find funds that meet their needs, but also (3) cheaper for sophisticated investors to learn about asset returns. Some experts believe this may increase financial inclusion, others worry about possible anti-competitive effects that can lead to a more unequal wealth distribution. To settle this debate, I build a theoretical model of intermediated trading under asymmetric information that allows me to study each innovation in isolation. In the model, these changes have opposing implications for financial inclusion, competition, and inequality. The final outcome depends on which one dominates. Interpreting the data through the lens of my model suggests that the gains from financial technology were accruing to low-wealth investors before the 2000s, but they are now accruing to high-wealth investors. The reason this is happening is that even if investors have access to the equity premium through cheap funds, improvements in financial technology disproportionately benefit informed, big data players. This reduces the participation rate of low-wealth investors, improves price informativeness, enlarges (but consolidates) the active investment management industry and amplifies capital income inequality.

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Keywords: Financial technology; stock market; asset management; information; participation; inequality.

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