AGENDA


Robinhood co-founders Baiju Bhatt and Vladimir Tenev in the middle of their merry band

Playing for Zero

The iPhone app Robinhood lets you trade stocks for free. What could possibly go wrong?

ILLUSTRATION BY MATT TAYLOR

THE PITCHMAN FOR ROBINHOOD, THE no-fee stock brokerage, looks a little like actor Seth Rogen: bearded, chubby, and, to some viewers, possibly stoned.

In the company's 80-second online ads, he takes aim at millennials, assuring them that they don't need much cash to triumph in the stock market. Using Robinhood, he says, you don't even have to pay the industry-standard trading commissions that can erode profits on the small trades newbies tend to make. All you'll need is Robinhood's sleek iPhone app. (Android and Web versions are in the works.)

The 25-person startup is the creation of Vladimir Tenev, 28, and Baiju Bhatt, 30. The two were roommates at Stanford University, where they studied physics, before moving to New York in 2010 to build high-frequency software systems for hedge funds and banks. The Occupy Wall Street Movement took over Zuccotti Park while they were there, and writing computer code to help the rich get richer left them feeling unfulfilled. "People expected more from us," Bhatt says.

Working on Wall Street also taught them that the true cost of a trade had fallen to fractions of a cent, at least for institutional customers. Meanwhile, retail investors were stuck paying as much as $10 per transaction online. Tenev and Bhatt wondered if they could find a way to bring zero-commission trading to the masses. Their competitors were saddled with humans; they could shave costs with software. "Ten years ago, you wouldn't have been able to provide this service with 25 people," says Tenev, who looks like a young Steve Jobs. "It would have taken 500."

They flirted with calling their company CashCat after cashcats.biz—a website with photos of felines lounging among $100 bills—before settling on Robinhood. After all, they would be spreading the stock market's wealth to their own skeptical, struggling generation. "There are a lot of people in our age group who have lost faith in the system," Tenev says.

It was a hard sell with venture capitalists. (A startup called Zecco offered zero-commission trading in 2006 and then revoked the deal over time.) But Google Ventures made a small investment in late 2012, and then Robinhood landed $3 million more in seed money from Index Ventures, Andreessen Horowitz, and angel investor Tim Draper in September 2013. Two months later, Bhatt and Tenev made public their plans for free trading. The waiting list for early access to the app reached 10,000 in just an hour; within months, it had surpassed 500,000, with people peddling invitations on EBay. Robinhood raised a further $13 million in September from a group that included celebrities Jared Leto and Snoop Dogg. "Congrats 2 tha @robinhoodapp team on their launch!" Snoop tweeted on Dec. 11, shortly after Robinhood hit Apple's App Store. "Buy low stay high."

Like many Silicon Valley idealists, Bhatt and Tenev insist that users come first and that their startup will focus on generating a profit later. But, when pressed, they say they make money by gleaning some of the interest on cash held in customer accounts and soon will charge users to borrow to make trades. On Wall Street, the latter is called leverage, or margin. It can be treacherous for individual investors as well as finance professionals; the Nobel Prize–winning Ph.D.'s at Long-Term Capital Management found that out when their hedge fund blew up in 1998.

Margin lending can be lucrative. E*Trade Financial charges as much as 8.4 percent; the highest rate at TD Ameritrade Holding is 9 percent. Tenev says customers would need to complete a suitability questionnaire before being able to trade on margin and have at least $2,000 in their accounts (the minimum required by U.S. regulators). Robinhood also plans to charge for short selling, another practice that can dent the portfolios of day traders and professionals alike; it, too, may be offered later this year.

Allowing millennials to buy stock with leverage and go short, let alone trade for free from their iPhones, could get ugly, says Kate Holmes, founder of Belmore Financial, a Las Vegas–based financial planning firm that caters to the generation. Many Americans aged 18 to 34—Robinhood's target demographic—are financially illiterate, she says. "I keep hearing people who don't know what a mutual fund is say, 'I'd like to trade stocks,'" says Holmes, herself a millennial at 31. "Please do not encourage anyone to trade on margin!" she adds.

If Robinhood ends up attracting enough followers, the company could force commissions to zero across the industry, says Michael Guillemette, a professor of financial planning at the University of Missouri. "I think it will cause the big brokerage houses, like Charles Schwab and Fidelity, to follow suit," he predicts.

Guillemette, 30, uses Robinhood to buy just a few shares of an exchange-traded fund with every paycheck. Micropurchases like that don't make sense if each one costs $7 or $10, he says.

If the big guys are fretting, they aren't showing it. "Zero-commission trading is not new," says Katrina Booker, an Ameritrade spokeswoman. "We continue to watch this, but it's not something that we worry about."

Tenev and Bhatt say that, so far, they are creating investors, not wild-eyed speculators. "The average customer places four or five trades a month," Tenev says. "They aren't becoming day traders."

ANTHONY EFFINGER

RACE TO THE BOTTOM

HOW MUCH AN ONLINE TRADE CAN COST YOU

*iPhone only