Fintech, Competition & Financial Inclusion

Thomas Philippon

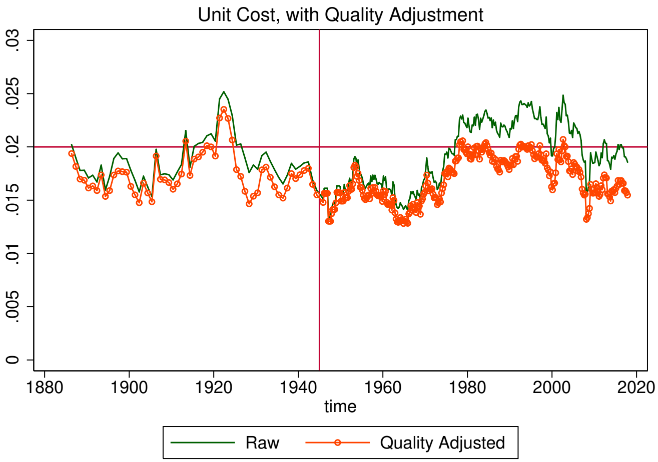
New York University, NBER, CEPR

CEPR, Sept. 2020

Fintech: Opportunities & Challenges

1. Competition is (finally!) increasing in the finance industry
2. Will Fintech increase access to asset management services? Yes.
3. Will Fintech reduce discrimination? Probably yes. Eliminate it? Probably not.

Unit Cost of Finance (US)



Source: Philippon (AER, 2015, updated)

Fintech in Asset Management: A Tale of Two Fixed Costs

- Asset management costs: ϕ per client, Φ to enter.
- Households with wealth $w \sim G(w)$.
    - participation cutoff: $\bar{w} \propto \phi$.
    - firm entry cost: $E[\text{profits}] = \Phi$
- Fintech: high Φ, low ϕ

- **Prop. Democratization** *If fintech entry is profitable then participation increases:* $\bar{w}^F < \bar{w}^B$.
- Rich investors pay for Φ, poor investors benefit from low ϕ

Machine Learning and Discrimination

- Aigner and Cain (1977), fundamental credit quality, majority / minority groups. Traditional lenders meet face to face: information & bias.
- Fintech use non traditional data and does not meet face to face
  - If algos are trained directly on outcome variables, they will learn and avoid human biases
  - But if they are trained to replicate human choices, they will replicate biases and probably increase them
  - They would also learn how to exploit behavioral biases

Open Issues

- APIs
  - The growth of fintech also increases the salience of the data ownership issue. A successful open banking ecosystem requires a good protocol for APIs
- Regulatory challenges
  - Regulating algos
  - Sandboxing after Wirecard