Capstone Project Summary

Profitability Analysis of the Brokerage Industry in 2018-2020

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Introduction

The aim of this projected was to provide a description of how brokers in different regions generate revenues to evaluate their potential in the coming years and identify the most notable trends within the industry. With the rapid development of online brokerage industry, facilitated by the high trading volumes and stock market volatility in 2020, this initial look would serve as a determinant of the profitability drivers within the industry and to what extent they are affected by changes in the economic environment. In addition, the cross-market comparison between different markets can provide an overview of the potential effect that can be caused by changes in revenue composition and how the diversification of the revenue-generating activities can be conducted in order to maximize profits.

Methodology

The fundamental analysis was done by explaining separately the key revenues and costs for each broker and using that to identify last years' trends within the industry. The data consists of financial information, presented by the brokers in the form of annual reports, SEC filings and press releases. The information was also collected from company's websites and investor presentations, which generally provide an overview of the broker's financial performance for the given year. The impact of the profitability drivers was evaluated as a share of the revenue rather than a number due to the fact that brokers disclosed their results in different currencies.

In addition, the growth rate of the revenues and costs was used for comparisons between brokers to determine the development of each category in recent years.

Main Results

- Revenues from commissions declined in 2019 due to zero-commission policy, but COVID-19 outbreak reinforced commission income in 2020.

- Order flow of payment became more critical profitability driver in 2020 in the US market.

- Interest revenue makes up nearly half of revenues in the US market brokerage industry, while in the UK/Europe market its role is less critical to the profitability.

- Commissions and fees income in the UK/Europe has shown a massive increase mostly due to the brokerage related income with some brokers doubling their revenues from this category.

- UK/Europe are increasing their employee compensation at a higher rate than the US market.

- Trading revenue is the key component of profitability in CFD market, which takes up more than 95% of the revenue.

- Marketing expenses are increasing, resulting in a significant expansion of the customer base in the CFD market.

Potential Implementation:

From the analysis it will be possible to:

- Get insights how the market is moving, what profit potential the brokers have and what revenue potential they can have..

- Provide their customers with a more comprehensive information on the broker.

- Provide analyses for news agencies, such as Reuters, Bloomberg, WSJ, etc.

- Include the profitability sources into the scoring system of the brokers to create a more detailed ranking of different brokers for its customers.

Given the dynamics of commission revenue changes in the US in 2018-2019, it is possible to project these potential changes to the UK and Europe markets and evaluate the effect of zero-commission trades on their market. In addition, the analysis helps to evaluate the effect of the interest income on the brokers and their sensitivity to interest rate changes, which in some cases can seriously damage profitability.

Learning Experience

My personal motivation for this project was to understand the structure of the online brokerage market and the main drivers behind their growth. During the project I learned more about the revenue composition of the key players in the brokerage industry around the world and the differences between brokers' financial performance and revenue-generating services based on their geographic location. In addition, I discovered the ways in which brokers developed in the recent years with regards to their revenue and expenses growth rate, which helped me to understand their main objectives for the profitability structure. I also learned a lot about the brokers with regards to their disclosure of financial information to the regulatory authorities. While listed brokers are required to file the 10-K forms or similar reports, the non-listed brokers are more selective with the information they are publishing in the open sources. Overall, this project allowed me to sharply increase my knowledge of the brokerage industry, which will be beneficial in my future career as a FinTech professional.