

Onchain Capital Formation and Coordination

Formation

Onchain capital formation is a lofty phrase.

What does it mean?

Simply this: funds move into a program.

These funds can be any cryptocurrency asset or token. Funds can be deposited by individuals or groups. The program—also known as a *smart contract*, which runs on a global computer that anyone can use called the *Ethereum Virtual Machine*—can custody or escrow these funds, and define unalterable rules governing their movement and use.

With such a system we can permissionlessly, securely, and anonymously pool capital in order to achieve shared goals. We can independently verify claims made by the program authors, and crucially, we can do all of this natively on the internet, outside the constraints of a geographic jurisdiction.

By expressing in code what has historically been manually drafted legal and accounting contracts, we get the economies-of-scale benefits of software. Namely, that the marginal cost of every new dollar contributed, as well as each new cooperative round of funding, are both *zero*.

This is important because in a capitalist society, *capital is leverage*, and leverage is *power*.

Today, this power is highly concentrated: the majority of capital is held, and leveraged, by an elite minority.

Onchain capital formation has the potential to change this.

How?

An emergent property of efficiently coordinating financial resources at scale is that individuals, each with relatively low leverage in society, are transformed into a high-leverage collective. Thus, through the alchemy of mass coordination, the weak can become strong.

To date, the three most common forms of onchain capital formation are token sales, auctions, and crowdfunds. Sales and auctions are often for tokens or onchain membership credentials; these tokens and credentials are imbued with privileged access and voting rights for deciding how to allocate the proceeds of the sale or auction. Crowdfunds are composed of individual contributions to an onchain campaign or project that may or may not include additional benefits for contributors.

Though raising capital is hard, deploying it efficiently while maximizing impact is even harder. These new onchain forms of collective bargaining power present their own unique challenges, in particular, *governance*.

Before funds will move into a program, the question *for what?* must be convincingly answered. After they've been moved, the next question is *now what?* The answer takes us from capital *formation* into capital *coordination*.

Coordination

Much has been written about onchain governance. Theory aside, what do we observe as the dominant forms of group decision-making onchain? *Direct democracies* and *benevolent dictatorships*.

Onchain democracies typically rely on a system of written proposals and token voting to make decisions for how to allocate collective capital. Group members submit written proposals and their peers vote *yes*, *no*, or *abstain* with their tokens. Sometimes these votes are binding by virtue of the fact that they are onchain, in which case funds are transferred, or not, based on the outcome of a vote. Other times, votes are offchain and dependent on a trusted individual, or group of individuals, to execute a transfer or other action based on member consensus.

Sometimes token distributions are “fair” in that no small group of holders possess an outsized proportion of voting power. Other times, they aren’t. Sometimes the quorum threshold is high, which requires a large proportion of members to explicitly express their preferences in order for an action to be taken. Other times, it isn’t.

These inputs on decision-making—tokens, quorum, proposals, and votes—are both powerful and complex. Creating organizations that benefit from the flexibility provided by these inputs, clearly communicating how they interact, and understanding how to participate in them requires a non-trivial amount of effort.

Though the process of reading and writing proposals, gathering context, and understanding tradeoffs is time-consuming, the benefit is that engaged members can make informed decisions. These decisions incrementally move the organization forward, closer to achieving the members’ shared goals.

An alternative to group-based decision-making is individual decision-making: instead of members themselves bearing the time cost of governance, they rely on a specific person, a “dictator”, to decide on behalf of the whole.

The benefit to this approach is that the burden of participation is significantly lower. The downside is that it compels members to place an enormous amount of trust in a specific individual.

As described, these forms of organizing are polar opposites. In practice, they are more similar than different. Successful onchain groups, organized as a democracy, are often the result of extremely active, passionate, and charismatic leaders who marshal the imagination and collective energy of disparate community members. Similarly, hard-working, creative, visionary individuals, serving as ‘dictator’, often factor in feedback from trusted advisors, take seriously the input from their supporters, and act in the best interest of their community.

Frontier

The program controlling capital formation can have functionality beyond mere money collection. For example, the Fabric crowdfunding protocol facilitates the permissionless pooling of capital and verifiable sharing of upside: anyone can launch a crowdfunding campaign, raise funds, and distribute returns to contributors on a pro rata basis.

Here are five insights we've had while building crowdfunding:

1. Capital is upstream of almost all communities.
2. Communities without capital lack leverage. Capital without community lacks purpose.
3. No single protocol, platform, product, or process can contain a community. Authentic, engaged communities are diffused across online and IRL spaces.
4. All communities begin with at least one prime mover: a creator, founder, instigator, or leader.
5. Most people are willing to support credible founders who share their values and have demonstrated an ability to execute.

We can see three common elements emerge around crowdfunding: *ideas*, *capital*, and *execution*.

Ideas are specific proposals for how to move the organization forward. They answer the who, what, where, when, why, and how for a given set of suggested actions. *Capital* can be financial resources, time, reputation, or social status. *Execution* has two facets: ability and willingness. Some individuals or organizations have one but not the other, others have both, some have neither.

Ideas, capital, and execution are the raw materials of onchain organizations.

Some categories of individuals are:

1. Bootstrapped builders who leverage their personal runway, and willingness and ability to execute their own ideas.
2. Idea Guys who write threads and opinion pieces but rarely—for lack of capital or execution ability or willingness—bring their ideas to life.

3. Venture Capitalists who allocate financial resources but often don't fund their own ideas or don't have in-house execution.
4. Freelancers who have an ability and willingness to execute but lack ideas they are willing to invest sufficient time or capital into in order to bring to life.

Some categories of groups are:

1. Decentralized Autonomous Organizations created with a general goal, purpose, or mission. They have either already pooled capital, or possess the mechanisms to raise funds, and their members are both willing and able to execute, but often lack consensus on which specific ideas to take action on.
2. Crowdfunds created with a specific idea, ability and willingness to execute, but lacking capital.
3. Bounties created with a specific idea and capital, but lack of ability or willingness to execute.

	IDEA	CAPITAL	EXECUTION
Individuals			
Bootstrapped Builder	✓	✓	✓
Idea Guy	✓	—	—
VC	—	✓	—
Freelancer	—	—	✓
Groups			
DAO	—	✓	✓
Crowdfund	✓	—	✓
Bounty	✓	✓	—

Again, the real-world is often more chaotic and less ordered than the table suggests. These are temporal entities: they exist in, and change, over time. DAOs develop ideas, crowdfunds raise capital, and bounties execute.

Present-day tools for onchain capital coordination are both powerful, and still in their infancy. There are many legal and regulatory headwinds facing this technology. Its power to disrupt, transform, and democratize access to capital and financial upside represents a clear and present danger to institutional incumbents.

Nevertheless we remain optimistic: the arc of history is long and bends toward freedom.

“I don’t believe we shall ever have a good money again before we take the thing out of the hands of government, that is, we can’t take it violently out of the hands of government, all we can do is by some sly roundabout way introduce something that they can’t stop.” – F.A. Hayek