market notes: Disruption is Dead! Long Live the Disruptor.

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2/2/24 – Marcel Kasumovich, Deputy CIO, Coinbase Asset Management

1. Why does PayPal like crypto? Mr. de la Ponte says it best: "I've been in payments for the best part of the last 20 years, and I think that this is the first time that I have seen a technology with the potential to radically change payments. The cost of an ACH transaction is around 50 cents. The cost of a debit card transaction is 30 to 70 basis points. So, if you have a technology that allows you to do payments 26 times cheaper, you can't let that technology pass by."

2. PayPal is a payment company. Their innovation was centered on user experience, not payment technology rails. The winning strategy was to make it easier to send and receive money over the internet. Its network surged through 2020, rising 4 times in ten years to 325 million active users. Its share price rose nearly 6-fold over the same period. But the network has stagnated recently, bringing attention to increased efficiency. Stablecoin is PayPal's solution.

3. It isn't new. PayPal started incubating crypto technologies in August 2019, a period when Bitcoin was left for dead. Those operating in traditional payment technologies emphasized that the protocol was too slow and too expensive. PayPal lab tests, in contrast, were doing a transaction at one-hundredth of a US cent. And despite technologies to the benefit of consumers, the SEC cast doubt on PayPal's plans, contemplating stablecoin as a security.

4. PayPal is a microcosm. It demonstrates that crypto is bigger than buzzwords. We're talking about technology, not tokens. The token vessel that moves the asset around is a necessity of the technology. The cash flow of a bond with physical coupons, an electronic version in a brokerage, and one identified by a digital token, all carry the same economics to its owner. And as crypto enters the mainstream, investors must broaden what it means to be "crypto."

5. PayPal is a crypto company because the future of payments runs on crypto technologies.

6. As mainstream companies adopt these technologies, lines are being blurred for native crypto companies, too. They are confronting the realities of running a business and not a growth narrative. Even with the sharp recovery in asset prices and activity, restructuring to improve efficiency is the new normal. Take Polygon. The CEO announced a spin out of their ventures and digital identification units while trimming employees by ~20% – mature business decisions.

7. Crypto's entry into the mainstream isn't a play on today, either. It's the future. Take Blackrock, the world's largest provider of exchange-traded products (ETFs). They run more than 400 strategies with total assets in excess of $2.5 trillion and the single largest ETF of more than $400 billion. Its annual revenue run-rate is $17-18 billion, with more than 60% of that fee income. Efficiency and scale are Blackrock's superpowers. Crypto technologies threaten both.

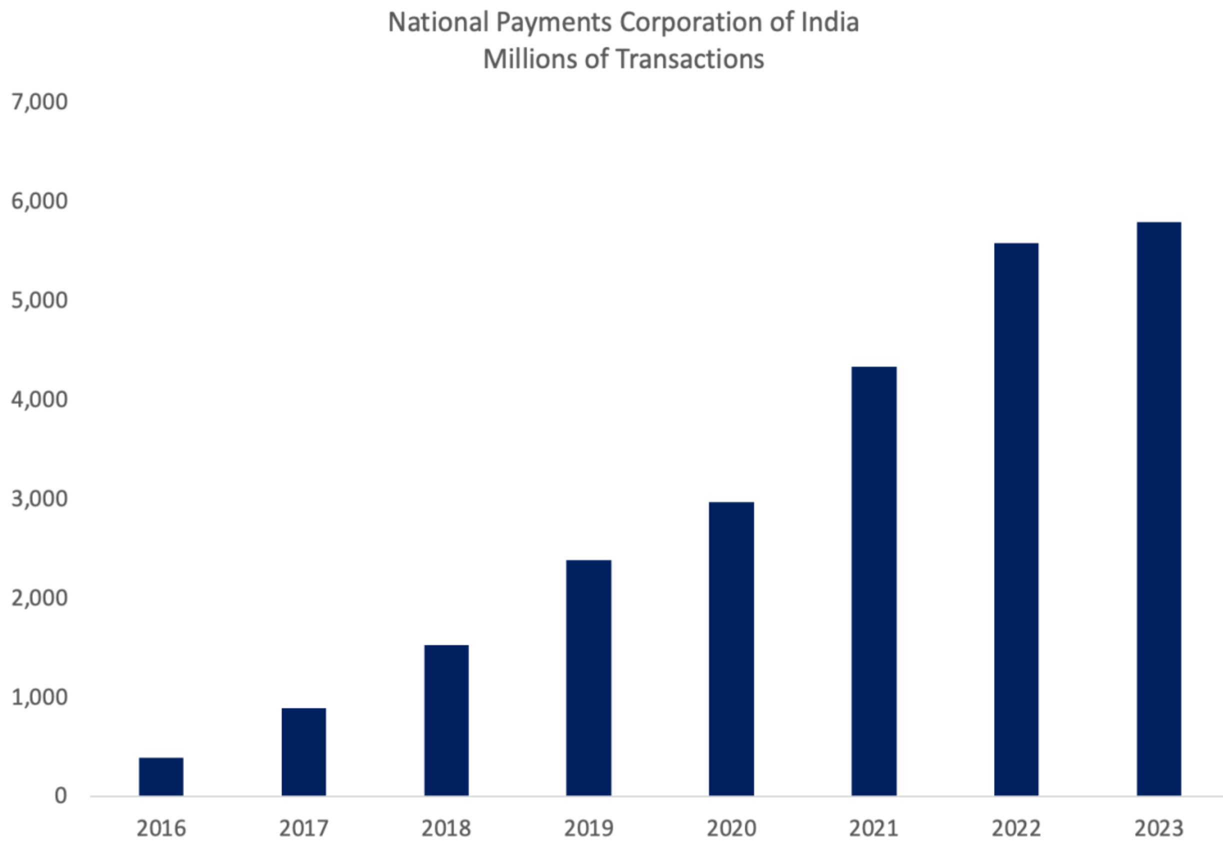
8. Then comes the Bitcoin ETF. The ETF in isolation is a rounding error. At 10-times its current ETF size, Blackrock would generate ~$75 million in revenue adding ~40 basis points to its topline. The ETF is the starting line. As crypto technologies become ubiquitous, the ETF wrapper can be replaced with an onchain oracle that adjusts to investor preference. Micro saving and investment become the norm. To avoid disruption, one must embrace the disruptor.

9. The disruptor and the disrupted can live in harmony. Take Figure and its platform for home equity loans. Like the value of PayPal, Figure delivers a compelling user experience. It's easy to get a loan. Rather than disrupted, financial intermediaries like banks walked away from the origination business and became buyers of the home equity loans originated by Figure. Their efficiency advantage? The use of blockchain technologies that shred administrative costs.

10. But this is not a US-led winner-take-all technology. The western world can be flattened by disruptors, too. One global leader in payment infrastructure is India – only launched in 2016. It opened the door to 145 million unbanked and disintegrated the unrecorded economy. It's also a key place to watch for blockchain integration. There are more than 800 banks on India's platform and transactions have surged (Figure 1). Yet, its leadership warns its constituents.

11. "Financial institutions are encouraged to adopt a disruption mindset for the adoption of blockchain and focus on creating new business models in favour of the customer." That's the message from the Chief Technology Officer for India's National Payments Corporation. Even Google thought the US Federal Reserve should import India's technology. Innovation doesn't respect borders. And nobody has a monopoly on common sense.

Figure 1: Mirror mirror on the wall… India is the best payments platform of them all?!



Source: National Payments Corporation of India.

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