Introduction

This article serves as a follow-up to earlier contextual pieces that establish a framework for key concepts in our strategic recommendations and provide an understanding of our approach. The prior articles included discussions about how we aim to leverage captive and non-captive investment vehicles, as well as "fund in a box" investment vehicles.

It extends those concepts by highlighting one key market opportunity that is actionable now and that addresses all three guiding principles from the ecosystem investment thesis:

- Building proprietary pipelines
- Supporting builders and product growth
- Boosting the capital ecosystem

Securing a Stronghold in OpenFi

Arbitrum has established itself as the home of DeFi, but the market is continually evolving. We believe Arbitrum needs to look forward and create a stronghold in the next phase of web3 finance.

During our Market Consultations, we identified key areas of alignment between Arbitrum's current position as the home of DeFi and the OpenFi movement, which aims to connect DeFi innovations with real-world use cases in an open, interoperable, and modular financial system.

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note: One of the market consultations that effectively framed these issues from an Arbitrum perspective was with idOS, which we consider to be one of the leaders in decentralized identity—supporting a user-friendly yet compliance-ready open financial infrastructure. While they've received funding from Arbitrum for a shared vision, we identified untapped potential for further collaboration, which we will expand upon at a later date.

Based on these discussions, a repeated focus area was how to expand Arbitrum's strong foothold in DeFi by facilitating the sustainable onboarding of non-crypto-native users and assets onchain. This brought us to revisit the concept of the "DeFi mullet: TradFi interfaces powered by DeFi backend."

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The mullet, in short, is a strategy that combines traditional finance (TradFi) interfaces with decentralized finance (DeFi) backend systems, aiming to make crypto more accessible while retaining decentralized functionality. As a result of this insight, we directed our analysis towards opportunities in the space where FinTech and DeFi meet.

Before we go further into the specifics of our approach, let's put web2 FinTech companies in perspective.

The Relationship Between DeFi and FinTech

Web2 FinTech and DeFi share an evolving relationship with competitive overlap.

Web2 FinTech revolutionized how people interact with money, moving banking from brick-and-mortar branches to the convenience of mobile phones. It's been 15 years and these companies, once pioneers, are no longer the frontier tech. They have matured and shifted their focus to stability, cost optimization, and lower-risk strategies. In contrast, DeFi is just getting started, filled with builders ready to move fast, break things and capture new territories.

Right now, many people are ready to move beyond the challenges posed by unfriendly regulation and control and want solutions that enable greater freedom and flexibility than those offered by traditional finance. The user base is calling for change and change happens at the frontier.

Web2 FinTechs are keenly aware of this. Conscious of the competitive pressures, they are adjusting their strategies to retain users and protect unit economics. Neobanks for example, have already started expanding their offerings to cater to the growing interest in crypto. With these developments, Neobanks and Crypto Wallets are now natural frenemies - they are both racing for growth and both racing to capture users and assets from traditional finance. Unlike prior cycles, adoption has unequivocally crossed the proverbial rubicon.

Take for example,

- Stripe's $1.1bn acquisition of Bridge, a startup focused on enabling stablecoin payments
- Stablecoins hold approximately 2.5% of U.S. Treasurys, ranking them as the 16th-largest holder – ahead of major global sovereigns, such as South Korea and Germany
- Nubank, a $50bn FinTech and Latin America's largest, partnering in Q4 2024 with Circle to offer experiences with digital dollars

For web2 FinTech's, ignoring these frenemies is perilous. Their respective races have merged into one - to capture the consumer user base and to deliver novel financial services. The competition for the consumer also means competition for attention, for disposable income, for assets. The ability to not only attract but retain users hinges on the ability to provide ease of use and accessibility, making UX the linchpin for success in this space.

Which leads us back into the topic for today - how can we use this relationship to our advantage in positioning Arbitrum for the next 5+ years of DeFi growth and adoption through investments.

Opportunity Summarized

As a result of our conversations with 50+ builders and investors, we directed our research into DeFi protocols relevant to serving the userbase of Web2 FinTech products by integrating DeFi-enabled features. Imagine Revolut Ultra offering their users the ability to set up a high yield savings account by onramping their funds into an Arbitrum-powered wallet behind the scenes, then facilitating the execution of all relevant transactions across relevant DeFi protocols in just a couple of clicks. Or think about empowering M-Kopa to be able to offer their users undercollateralized fixed-interest point-of-purchase loans, backed by onchain liquidity and qualified using transactional data directly from M-Kopa.

This future isn't far. These are plausible scenarios. In a world where DeFi is becoming increasingly well-regulated and stable, the more traditional financial institutions will need to adapt and leverage its potential, or they will risk falling behind. We're already seeing solutions where things like remittance payments onchain are an order of magnitude cheaper than pre-existing solutions, where multiple parties are necessary who all skim fees off the top of each transaction.

For example, neobanks already see their unit economics positively impacted by adding new services. Services like lending have become increasingly important for them and, in their journey to provide these at competitive levels, some have started offering money market funds. However, these are dependent on the monetary policy of the central banks in the jurisdictions they operate in.

We have explored scenarios where DeFi protocols could offer more favorable (and profitable) terms driven by market phenomena like the pattern of long bias that is sticky and consistent with the positive market momentum, and ultimately will be driven by activity in the onchain economy. A process that revealed a practical path to capitalize on these emerging OpenFi trend by taking inspiration from Plaid's transformative role in Web2 fintech of seamlessly connecting consumer apps with financial institutions via API integrations.

In a similar manner, Arbitrum can pioneer a "Plaid for Crypto," offering a modular product that bridges DeFi with user-friendly Fintech apps. By integrating stable DeFi infrastructure into consumer-facing platforms, Arbitrum can enable neobanks and financial services to offer accessible features like lending, borrowing, and onchain investments.

Practical Steps Toward the North Star Vision

The full vision for the opportunity above might take years to materialize, but we have identified immediate potential investments that align with such a long-term goal and make it ever more likely that that business will ultimately run on Arbitrum. We are well-positioned to take a more patient approach compared to other shorter-term oriented players in Web3, and as a result Arbitrum Ventures can offer a unique value proposition to attract top-tier players already working on the steps needed to realize the long-term opportunity.

Our key task as investors is to establish the market opportunity, determine the strategy to execute on it and back the teams to realize the market opportunity in ways that leverage Arbitrum's resources to eliminate the barriers for those heading in a direction that is strategically valuable for us.

With this in mind, we spoke with a variety of protocols to understand what drives them and would encourage them to embark on this path in alignment with Arbitrum. A couple notable examples include:

- Gearbox provides under-collateralized loans, which could be integrated into a "fat wallet" solution that companies serving underbanked users might use for a new undercollateralized debt product.

- Additional lending protocols were interviewed, for which disclosure approval is pending, which can fulfill the need as part of the composable lending and deposits stack, paving the way for new types of consumer borrowing experience. Some of which have traction on mainnet but are yet to decide where to deploy on L2s.

In most cases, what really matters to these protocols is our ability to provide them with high quality patient liquidity for their lending pools, as opposed to simply investing in them directly. Equally important is our role in supporting a vibrant ecosystem with the various necessary players trying to go to market in an integrated way around a clear vision like the one outlined above.

This highlighted a key opportunity: incentivising patient and sticky behaviour by market participants can be seeded by creating a captive liquid fund that implements policies to drive more patient liquidity, supporting various ecosystem objectives. The healthy market behaviour would then be further reinforced by the new iteration of the incentive programs that the DAO working group is currently working on.

Key Strategic Maneuvers

As mentioned above, to realise the opportunity of onboarding users and assets onchain via DeFi x FinTech, Arbitrum can pioneer a modular product (or a recommended portfolio of products) that bridges DeFi protocols with Web2 FinTech products.

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Some examples of building blocks we need to address include:

- Enabling a “Plaid for crypto” - compliant infrastructure that connects into composable DeFi protocols;
- Arbitrum-aligned wallet addressing the technical and regulatory needs of neobanks
- Lending pools supported by more sticky and patient capital.

What might this look like?

Under the hood, smart contracts and protocol integrations do the heavy lifting. The vast majority of users don’t care to understand how AMMs, yield optimizers, and lending pools work; In this vision of optimized UI, they are able to simply click a couple of buttons in the already familiar interface of their preferred neobank and the system executes their “intent” from start to finish.

This approach will likely be based on an abstracted or wrapped Arbitrum based wallet created on the users behalf. Over time the users can take control of their own keys and approach it as fully non-custodial, using it in a more Web3 native way. This will especially be the case as the solutions evolve and become more usable and human centric. Ultimately, the goal is to embed DeFi yield and lending services into familiar consumer finance products without forcing users to navigate additional complexity.

This approach simplifies complex DeFi strategies, fosters stable liquidity, and positions Arbitrum as a leader in the merge of DeFi innovation with mainstream usability.

The Need for “Sticky Liquidity”

A stable user experience demands stable liquidity. DeFi protocols often boast high, short-term yields driven by fleeting market opportunities. Meanwhile, traditional finance customers want long-term predictability and reliable returns. To bridge these worlds, we need “sticky liquidity” - longer-term, committed capital in lending pools and liquidity pools that doesn’t vanish at the first sign of volatility.

The Arbitrum ecosystem can lead in crafting this stability. By orchestrating a reliable supply of liquidity that’s less sensitive to short-term speculation, we can help DeFi protocols serve consumer financial apps with confidence. This, in turn, encourages wallet providers to integrate more robust features, and allows neobanks to offer products that feel steady and secure, all while being built on composable DeFi infrastructure.

Strategy Implementation

To support the above outcomes via an investment strategy, our research findings suggest that our position will be strongest if we focus on both captive and non-captive strategies. For more details on our approach, see: [Captive vs. Non-Captive Vehicles]

To bring the vision of a “Plaid for Crypto” to life, we identify the following opportunities:

1. Captive Strategy:

We incubate a captive fund over which we have high levels of control that’s exclusive to the Arbitrum’s ecosystem:

- That probably entails front running any administrative and regulatory costs ensuring that we have a vehicle that feels safe and accessible for LPs and its good operations are guaranteed or endorsed by Arbitrum.
- Identifying a manager and allocating capital (eg. $1m) for a test period in which certain strategies are piloted and traction demonstrated.
- Committing to match 25-50% of the total fund size, up to a limit, for any funds raised by the manager from other LPs that are committed to provide liquidity in a way suitable to support the above thesis.
- A leverage point we can use further is by having differentiated terms for Arbitrum and the other LPs in favor of the latter that we can gradually taper off as the models become proven or push on if we want to become more attractive again.
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- Non-Captive Strategy:

On the other hand we can make 3-5 investments of 500k-1m in other well-performing liquid funds that are established in the market:

- This will give us a seat at the table and participation in regular strategy workshops, helping us influence towards better understanding of Arbitrum’s long term vision.
- Allow us to pass alpha to them from our activities and receive such in return that our captive fund can take advantage of.
- Whenever there are new tokens coming out of the Arbitrum ecosystem or other relevant developments, be in a position to bring additional attention from these market players.
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- Allow us to pass alpha to them from our activities and receive such in return that our captive fund can take advantage of.
- Whenever there are new tokens coming out of the Arbitrum ecosystem or other relevant developments, be in a position to bring additional attention from these market players.

Through the continued iteration of the overall ecosystem investment thesis, we aim to create an adaptable, modular strategy that can evolve with the Arbitrum ecosystem and market conditions. Each component—whether a captive fund, a direct strategic investment into a wallet vendor, or a protocol partnership—should stand on its own merits. If one specific avenue fails to deliver, we are able to adjust without compromising the broader initiative.

End Note: Inviting Collaboration

Arbitrum has the opportunity to position itself as a leader in the OpenFi movement, defining the next era of DeFi. We invite the Arbitrum DAO delegates, protocol teams, fund managers, and community members—whether you’re a DeFi expert or new to these concepts—to help refine this blueprint.

By pooling our insights and feedback, we can craft a lasting framework that translates the raw potential of Arbitrum’s DeFi into an experience that is no longer confined to an audience that is still niche but becomes a cornerstone of global finance.

Learn more about the broader ecosystem investment thesis and its ethoshere.