[Non-Constitutional] M&A for Arbitrum DAO

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Discussion Comments:

Hi all, after the first kick-off in Denver and 4 weeks of running the Arbitrum M&A Working Group where we focused on developing an initial entity and operational structure for a potential M&A unit, formed an initial view on target selection, and aligned with interested parties, we have put our thoughts into this proposal to continue driving the topic.

For this, we would like to get your view as key delegates and stakeholders in the Arbitrum DAO.

Besides contribution to this document, we will reach out individually to schedule 1-on-1 feedback/calls.

The document will be open for comments until further notice.

We will present the status on the next Governance call on 23rd April.

Abstract

This proposal outlines the opportunity for Arbitrum DAO to form an M&A Unit focused on identifying and executing on M&A opportunities.

One of the primary ways for Arbitrum to scalably deploy capital and grow rapidly is to explore M&A transactions, and the upside is potentially massive.

Additionally, this is a largely untapped opportunity in crypto, only explored selectively by a few projects in the space; therefore, setting up M&A would enable Arbitrum DAO to set a precedent in the space.

The key objective of having an M&A Unit for Arbitrum is to act as a key growth driver for the Arbitrum ecosystem, help the DAO expand non-organically through acquisition opportunities, and cement its position as the leading L2 by productively utilizing its treasury.

This initiative, though being a heavy lift, would set a precedent for the entire crypto space and offers significant upside potential to the Arbitrum ecosystem if executed properly.

This proposal is solely to vote on the next Phase to drive the initiative forward. For completeness, we have outlined a preliminary view of the rest of the phases.

Acknowledgements

First of all big thanks to @jacobpphillips and @hiringdevs.eth for sparking the initiative at the GovHack in Denver, and everybody who has been actively contributing to move this forward @JoJo, @juanbug, @AbdullahUmar, @MattOnChain, @krst, @AlexLumley, @Djinn, and @lino.

Content

I. M&A Opportunity for Arbitrum

Our thesis is that M&A is a key driver towards cementing Arbitrum's position as the leading L2, and is one of the most productive ways of utilizing Arbitrum's treasury.

The crypto space is incredibly fragmented at the moment, and the M&A market is fundamentally nascent, presenting significant opportunities to scale and grow for active market participants. The unit could, for example, consolidate the fragmented L2 market where Arbitrum could buy up competitors, or help to grow the Orbit ecosystem by acquiring applications as L3s for Orbit. The design space is vast.

Furthermore, if the OpCo becomes a reality, the Arbitrum M&A Unit could play an integral role in scaling and helping the DAO achieve the strategic objectives set out.

Expected Outcomes

The Arbitrum M&A Unit has an overarching mission:

To act as a key growth driver for the Arbitrum ecosystem and help the DAO expand non-organically through acquisition opportunities that are not accessible for competing ecosystems.

Thereby, the three key objectives are:

1. Enabling access to value creation through acquisitions.

As can be seen in the DAO ROI section below, Arbitrum DAO can create value that can be judged via 1) financial metrics, 2) strategic value, and 3) long-term value.

1. Creating a strong ecosystem of self-operating, high performing companies owned by Arbitrum DAO

that are fully focused on the growth of the Arbitrum ecosystem.

1. Providing an exit opportunity for Arbitrum ecosystem projects

, thereby significantly increasing the attractiveness of building on Arbitrum.

Outcomes

:

Within the initial 2 years of the program, the aim is to establish Arbitrum as the leading crypto ecosystem with a functioning M&A unit proving its power with key strategic acquisitions that significantly grow the ecosystem, including:

- Executing 5-10 dedicated acquisitions of high-potential targets

to fuel their growth and that of Arbitrum, enabled by deep due diligence.

- Screening over 100 projects

to determine where the value lies in the Arbitrum ecosystem.

- Integrating acquired companies into the Arbitrum ecosystem

and unlocking value creation for 50+ affiliated companies within the Arbitrum ecosystem.

An additional outcome is that the program will complete the lifecycle for companies building in Arbitrum from small-scale to normal-sized grants up until providing access to a real exit opportunity becoming part of Arbitrum DAO and even potential consolidation of other L2s and competitors.

II. M&A Unit Structure

Throughout the last 4 weeks of the[M&A Working Group](), we have developed and iterated a structure to operate the Arbitrum M&A Unit. This structure still needs to be vetted from a regulatory and legal perspective as the key next step.

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The entity structure has the “Arbitrum DAO M&A Fund”

at its core being operated by the “Arbitrum M&A Mgmt. Co.”

as its General Partner. To provide additional checks and balances and information flow to the DAO, the “Arbitrum DAO Steering Committee”

will be put into place and will have significant oversight & veto rights around the decision-making of the General Partner entity. Funds are provided by Arbitrum DAO

as core Limited Partner.

Find more details on the individual bodies below:

1. Entity Ownership: Who holds the assets legally? & 2. Entity Management: Who manages the assets?
2. “Arbitrum DAO M&A Fund”

is structured as a limited partnership (LP) or limited liability company (LLC)

- “Arbitrum DAO M&A Fund”

owns the portfolio

- “Arbitrum DAO”

is a Limited Partner (LP) in the “Arbitrum DAO M&A Fund”

, i.e., has ownership stake in the fund which owns the assets. Thereby: 1. The investment amount into “Arbitrum DAO M&A Fund”

is decided by the Arbitrum DAO

1. Other parties can potentially become Limited Partner (LP) in the “Arbitrum DAO M&A Fund”
2. Disclaimer: Legal to specifically examine the methods by which the DAO can operate as a Liquidity Provider.
3. The investment amount into “Arbitrum DAO M&A Fund”

is decided by the Arbitrum DAO

- Other parties can potentially become Limited Partner (LP) in the “Arbitrum DAO M&A Fund”
- Disclaimer: Legal to specifically examine the methods by which the DAO can operate as a Liquidity Provider.
- “Arbitrum M&A Mgmt. Co.”

is General Partner (GP) in the “Arbitrum DAO M&A Fund”

, i.e., manages the fund investments. This includes: 1. Day-to-day operations of acquired companies are managed by their “Existing teams”, possibly with changes made by the “Arbitrum M&A Mgmt. Co.”

1. “Arbitrum M&A Mgmt. Co.”

has further checks and balances controlled by the “Arbitrum DAO Steering Committee”

1. “Arbitrum M&A Mgmt. Co.”

is equipped with legal support to ensure compliance of the construct and individual processes

1. Who?

We offer to fill this role with Areta as a 100% committed party to drive this, further outlined below.

- Day-to-day operations of acquired companies are managed by their “Existing teams”, possibly with changes made by the “Arbitrum M&A Mgmt. Co.”
- “Arbitrum M&A Mgmt. Co.”

has further checks and balances controlled by the “Arbitrum DAO Steering Committee”

- “Arbitrum M&A Mgmt. Co.”

is equipped with legal support to ensure compliance of the construct and individual processes

- Who?

We offer to fill this role with Areta as a 100% committed party to drive this, further outlined below.

1. Checks and Balances

2. “Arbitrum DAO Steering Committee”

is the key direct DAO body providing checks and balances from and information flow to the DAO. Thereby it:

1. Oversees “Arbitrum M&A Mgmt. Co.”

2. Steers alignment with Arbitrum DAO

community members and key stakeholder groups (e.g., delegates, key initiatives), incl. feedback loop

- Reviews performance and ensures accountability

- Reviews fund operation guidelines

- Has access to transaction-related info and veto rights for decisions:

- Access to confidential investment decisions of the “Arbitrum M&A Mgmt. Co.”

- Ultimate veto right on acquisition decisions

- Has power to:

- Call for additional audits (under certain conditions)

- Propose management changes

- Request detailed reviews of specific transactions / decisions

- Is elected via DAO governance

- Holds frequent communication with the DAO via office hours

- Who?

Steering committee of high-context parties/individuals elected via DAO governance.

1. Additional Support

2. Legal Support

3. Dedicated partner to ensure compliance of operations

4. Support legal entity set-up and operations

5. Dedicated partner to ensure compliance of operations

6. Support legal entity set-up and operations

7. “Technical Due Diligence Support”

8. Supports on Research & Due Diligence for target areas in an ad-hoc way (ways of working, research structure, timelines tbd)

9. Who?

Subject matter experts pulled in for technical due diligence when needed. In the future the ARDC could support this role with some capacity.

- Supports on Research & Due Diligence for target areas in an ad-hoc way (ways of working, research structure, timelines tbd)

- Who?

Subject matter experts pulled in for technical due diligence when needed. In the future the ARDC could support this role with some capacity.

III. M&A Unit Operating Model

Entity Oversight: Who oversees management of assets?

- Internal Oversight:
- By “Arbitrum M&A Mgmt. Co.”

as GP through internal committees and processes.

- By “Arbitrum DAO Steering Committee”

as checks and balances within the DAO.

- By “Arbitrum M&A Mgmt. Co.”

as GP through internal committees and processes.

- By “Arbitrum DAO Steering Committee”

as checks and balances within the DAO.

- External Oversight:

By “Arbitrum DAO”

as LP with oversight through rights in the partnership agreement, including receiving reports and voting on major issues.

- Regulatory Oversight:

Compliance with investment and corporate governance laws enforced by relevant regulatory bodies.

Target Selection: Who picks the targets and how should the DAO be involved?

- “Arbitrum DAO“

defines strategic target areas either with support of other initiatives (like the ARDC) or in an exercise led by the “Arbitrum M&A Mgmt. Co.”

- “Arbitrum M&A Mgmt. Co.”

will select targets and conduct due diligence.

- “Arbitrum DAO”

will take part in voting on target areas and steer the “Arbitrum M&A Mgmt. Co.”

with periodic feedback on reporting.

Transparency: How can we equip the DAO with enough information to make decisions?

- The “Arbitrum M&A Mgmt. Co.”

will act upon pre-agreed target areas. The actual decision to buy an individual company is not voted on individually by the DAO.

- Further, the “Arbitrum M&A Mgmt. Co.”

will release transparency reports to the DAO.

- "Arbitrum DAO Steering Committee”

as checks and balances within the DAO.

- For the first 2 deals done by the “Arbitrum M&A Mgmt Co.”

(of any size) there will be additional validation mechanisms put in place to ensure strategic alignment and quality.

Role of Foundation: What is the role of Arbitrum Foundation?

- Arbitrum Foundation

legal counsel collaborates with M&A legal party to make sure structure fits within the wider Arbitrum ecosystem.

Fund size: How large should the initial fund be?

- Although fund structures like these can theoretically scale up to double-digit billions, we believe it is prudent to start with a significantly lower budget and put in extensive checks and balances for each funding payout to minimize risk for the DAO.
- Comparable structures in the traditional market come with sizes between $100m and c.$25bn (Overview of largest buy-out funds here).
- Some examples that resemble our structure for context are:
- Bain Capital Fund XII: $8bn focused on leveraging Bain's strategic and operational insights to drive value (started with three-digit million funds as first funds and has proven concept over >30 years)
- ISAI Expansion III: $250m focusing on the tech buyout sector in France
- Carlyle Partners VII: $18.5bn focusing on aerospace, defence and technology (started with $100m and has proven concept over <30 years)
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- Carlyle Partners VII: $18.5bn focusing on aerospace, defence and technology (started with $100m and has proven concept over <30 years)
- This is a highly capital-intensive initiative that, if proven effective, could enable the Arbitrum DAO to uniquely allocate capital to bind high-impact projects to the Arbitrum ecosystem.
- However, as this initiative is an industry precedent - we aim to demonstrate its feasibility and value potential first. Therefore, we propose implementing a staged-funding mechanism to limit the capital risk to the Arbitrum DAO and avoid significant expenditures before the effectiveness of the model is confirmed.
- Thus, the three core principles for funding would be:
-
  1. Start with acquisition targets with lower capital needs and prove the concept first.
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-
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- Involve the DAO in decisions regarding fund size.
- Looking at the minimum size of comparable structure in the market, a fund size between $100m - $250m for the initial generation is deemed a reasonable balance between low risk and sufficient scale to be effective. This range considers the median historical purchase price for crypto M&A since 2021, which is $15m, and also provides ample capital for higher-end, opportunistic deals in the $20m-100m range.
- Such a fund size would support the acquisition of 5-10 major companies, aligning with both high-profile deals and additional smaller opportunistic acquisitions.
- Link to initial assessment ofCrypto M&A Transactions (FY21-YTD24)

DAO Fund Withdrawal Rights and Risk Mitigation

- Should there be major concerns or issues reported in the quarterly updates, a process will be in place that enables the DAO to shut down the structure and return funds to the DAO.
- Additionally, structuring the fund as a drawing facility mitigates the risk of budget authority for the “Arbitrum M&A Mgmt. Co.”

DAO ROI: How to measure ROI?

The ROI measurement for the Arbitrum DAO M&A Fund is educated by traditional corporate M&A/PE practices. In periodic instances (see “Reporting”) the “Arbitrum M&A Mgmt. Co.” has a duty to present ROI results and qualitative information about assets to Arbitrum DAO. ROI metrics should include:

- Financial Metrics:
- Growth attributed to the Arbitrum ecosystem:

Increase in key metrics in Arbitrum measured by quantitative metrics (TVL, Sequencer Fees, Transaction Volume, Number of Transactions, User Growth).

- Value created within Arbitrum ecosystem:

Increase in key metrics for Arbitrum affiliated projects directly affected by the target company’s performance.

- Target performance:

Expected vs. actual key performance and financial outcomes comparison post-acquisition.

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Increase in key metrics in Arbitrum measured by quantitative metrics (TVL, Sequencer Fees, Transaction Volume, Number of Transactions, User Growth).

- Value created within Arbitrum ecosystem:

Increase in key metrics for Arbitrum affiliated projects directly affected by the target company’s performance.

- Target performance:

Expected vs. actual key performance and financial outcomes comparison post-acquisition.

- Strategic Value:
- Technology and Market Position:

Significant additions to Arbitrum’s key strategic growth areas.

- Talent:

Retention of high performance teams measured by qualitative criteria and output increase per team member.

- Integration success:

Effectiveness of improving target operations.

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Significant additions to Arbitrum’s key strategic growth areas.

- Talent:

Retention of high performance teams measured by qualitative criteria and output increase per team member.

- Integration success:

Effectiveness of improving target operations.

- Long-term Value:
- Future Cash Flows:

Future cash flows projection vs. acquisition cost.

- Sustainable value add to ecosystem:

Number of project ecosystem initiatives or other key integrations with Arbitrum protocols/projects.

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Future cash flows projection vs. acquisition cost.

- Sustainable value add to ecosystem:

Number of project ecosystem initiatives or other key integrations with Arbitrum protocols/projects.

Reporting: How does reporting to the DAO work?

- Quarterly update reports covering decisions and performance of assets.

- “Arbitrum M&A Mgmt. Co.“

to hold bi-monthly town hall meetings educating the DAOs on strategic target areas and updating on progress.

- Independent party

for neutral auditing reviews on demand of the “Arbitrum DAO Steering Committee”

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- Additional updates from the “Arbitrum DAO Steering Committee”

in the form of office hours in collaboration with the “Arbitrum M&A Mgmt. Co.”

Commitment: How does the DAO ensure commitment of involved parties?

- Areta

is 100% committed to the Arbitrum DAO and are fully incentivized to make this structure a success. Not only would this be a significant precedent for the Arbitrum DAO, but similarly for Areta proving its ability to successfully execute this first-of-its-kind initiative in the space.

- We are aware of the responsibility we would assume with this initiative and are committed to fulfilling it completely. Should the DAO require additional mechanisms to demonstrate our commitment or to ensure we have skin in the game, we are happy to provide these.

Disclaimer

: The fund size and operational model are based on our assessment on the work completed over the last few months. Closer to Phase 3, we will complement this with a detailed iteration with the DAO to stress-test each element. However, any comments on this are highly appreciated and will help drive this initiative forward.

IV. Flow of Funds

With regards to checks and balances from the DAO, we propose that the total fund amount is held within the DAO’s treasury but is earmarked for use by the M&A Unit.

Given that the Arbitrum DAO Steering Committee has ultimate veto right on acquisition decisions, and the Steering Committee is a group of experts mandated by the DAO to act in the best interest of the DAO while reviewing the investment decisions of the Unit in the Investment Committee, we propose the following:

- The Steering Committee holds a vote to approve all deals and each deal requires a majority vote to be approved.

- For approved deals up to $25M, the Steering Committee has the unilateral right to call for the capital from the Arbitrum DAO treasury that has been earmarked for the M&A Unit.

- For the first 2 deals done by the M&A Mgmt Co. (of any size) there will be additional validation mechanisms put in place to ensure strategic alignment and quality.

Both of these deals will require ratification from the DAO. We propose the use of the Optimistic Governance Module being developed by Axis Advisory and Tally for this purpose, which would function in the following manner: * The “DAO Steering Committee”

will outline the deal to the DAO as proposed above.

- Delegates have a predetermined amount of time to veto the deal.
- If the deal is not successfully vetoed, the funds will be sent to the “Arbitrum M&A Mgmt. Co.”

to execute the deal. If the veto is enforced, the M&A Unit will pull out of the deal.

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will outline the deal to the DAO as proposed above.

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- If the deal is not successfully vetoed, the funds will be sent to the “Arbitrum M&A Mgmt. Co.”

to execute the deal. If the veto is enforced, the M&A Unit will pull out of the deal.

- For deals >$25M, the “DAO Steering Committee”

must get ratification from the DAO to go ahead with the deal. To preserve competitive advantage and the privacy of the deal, the Steering Committee will not be able to disclose all

aspects of the deal, but will outline the strategic rationale and benefit to the DAO from executing the transaction. Again, we propose the use of the Optimistic Governance Module here.

A summary of these rules is below:

Deal Value

Process

All deals

Reviewed by the Arbitrum DAO Steering Committee.

First two deals

Additional validation mechanisms put in place with added veto rights for DAO members.

Up to $25M

Steering Committee has the unilateral right to call for the capital from the DAO’s treasury.

$25M

Steering Committee must get ratification from the DAO via the Optimistic Governance process using the Optimistic Governance Module.

V. Way forward

The key next step to vet our current state of working and steer towards operationalization is the legal vetting of structure and processes. For this, we suggest following the key phases below, each of which would be subject to a DAO governance vote:

Phase 1: Feasibility Sprint & Community Review Period (16 weeks)

What?

- Before moving the M&A Unit into Phase 2, we need to clarify the legal considerations with Arbitrum pursuing M&A strategic transactions in a sprint, including:
- Validating outlined entity structure from a regulatory and legal perspective, especially ownership of equity and whether the DAO can own any equity.
- Engage with the community and all relevant stakeholders to stress-test the challenges and risks associated with the DAO engaging in M&A, and identify mitigants.
- Enable the community to review the findings of the assessment and signal their approval to formally form the M&A Unit.
- Given the current overlap of topic areas for legal assessment, we work closely with the two other groups (Gaming Catalyst Fund and Ventures). Having identified an initial entity structure with the M&A working group (see above), we are keen to drive vetting this specific structure.

- Further, we are happy to support the other initiatives in key overlapping areas of legal exploration within this feasibility sprint, especially around ownership of equity and whether the DAO can own any equity, and ensure that there will be no duplication of efforts.
- Validating outlined entity structure from a regulatory and legal perspective, especially ownership of equity and whether the DAO can own any equity.
- Engage with the community and all relevant stakeholders to stress-test the challenges and risks associated with the DAO engaging in M&A, and identify mitigants.
- Enable the community to review the findings of the assessment and signal their approval to formally form the M&A Unit.
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- Further, we are happy to support the other initiatives in key overlapping areas of legal exploration within this feasibility sprint, especially around ownership of equity and whether the DAO can own any equity, and ensure that there will be no duplication of efforts.

Disclaimer: The timespan for the feasibility sprint of 12 weeks is the maximum expected amount of time and is partly dependent on response time of legal partners. We aim to fulfill our parts of the legal workstream without any delay.

Who?

Areta

to steer the effort with a minimal team and only covering FTE cost purely focused on enabling legal parties.

Cost

- Direct budget facility for legal fees (unused budget will go back to the DAO): $100k
- Operational budget, i.e., minimal budget to cover cost for steering the workstream: $8k ARB / month over 3 months max

Phase 2: Strategic Target Setting & Target Identification (8 weeks)

What?

After feasibility is proven and the community has reviewed it, we will submit another proposal to start the execution of M&A activities. Before beginning the target selection process, we will align on strategic objectives and transition the group to get operational:

- Exemplary target identification sprint on one target area to provide the DAO with a better understanding of what it would mean to have the M&A Mgmt Unit operate and get full conviction of the existing opportunities.
- This will include a market assessment, and deep analyses of potential targets and integration opportunities.
- This phase is meant to be a dedicated time for alignment with the DAO and leaves room for collaborating on granular elements of how the unit should function (and solving the target area definition gap, in case this is still a gap by then).
- Each potential M&A transaction needs to align with Arbitrum's Big Strategic Bets. As these are currently still in development, alignment here is key before moving ahead with execution.
- Every potential M&A transaction must align with protocol development and other key DAO initiatives. It is crucial for the M&A Unit to establish an effective information flow to support both the augmentation of technical and protocol development, as well as the individual DAO initiatives.

Who?

Areta

to steer this effort with a lean team and collaborating with delegates, broader DAO members, and key initiatives.

- In case strategic target areas are not set by then, by any other initiative or through general alignment cross-initiative, Areta will additionally steer a collective effort to determining these through in-depth research and facilitating workshops across the DAO.

Cost

- Operational budget:

Minimal budget to cover cost for a lean team conducting the target identification and analysis: $25k ARB / month

- Access to Data Providers/Research Platforms:

$2k in ARB (remaining budget to be refunded to the DAO after Phase 2)

Phase 3: Operationalization of Arbitrum DAO M&A Unit (24 months)

What?

After feasibility is proven and an initial view on potential targets is formed. The operationalization of the structure and processes will follow. This includes:

- Operationalization of the entire structure, incl.
- Set-up of key entities and operationalization of processes
- Clear definition of roles and holding elections of relevant participating groups
- Engaging with the DAO and all relevant stakeholders to stress-test the structure and processes
- Set-up of interaction points and transparency mechanisms
- Set-up of key entities and operationalization of processes
- Clear definition of roles and holding elections of relevant participating groups
- Engaging with the DAO and all relevant stakeholders to stress-test the structure and processes
- Set-up of interaction points and transparency mechanisms
- Arbitrum DAO Management Co. going into effect and operating with a full team and oversight duties.
- Key activities include:
- Scanning for targets
- Exchanging information with potential targets and delivering management presentations
- Conducting financial, commercial, and operational due diligence on targets
- Financial modeling of target business and growth opportunities
- Developing strategic integration plans
- Reporting to the DAO and stakeholders
- Leading negotiations and structuring deals with targets
- Managing post-acquisition integration and optimization
- Overseeing legal reviews and contract management
- Conducting performance analysis and ongoing monitoring
- Developing and implementing growth strategies for portfolio companies
- Scanning for targets
- Exchanging information with potential targets and delivering management presentations
- Conducting financial, commercial, and operational due diligence on targets
- Financial modeling of target business and growth opportunities
- Developing strategic integration plans
- Reporting to the DAO and stakeholders
- Leading negotiations and structuring deals with targets
- Managing post-acquisition integration and optimization

- Overseeing legal reviews and contract management
- Conducting performance analysis and ongoing monitoring
- Developing and implementing growth strategies for portfolio companies
- Operations can be halted during any quarterly reporting period if quality concerns are raised by the DAO Steering Committee or wider DAO participants.

Who?

- Find detailed bodies and responsibilities above. Key parties include:
- „DAO Steering Committee“

to be elected via DAO Governance

- MSig Signers

to be determined in the Phase 3 proposal

- „Arbitrum M&A Mgmt. Co.“

to be led by Areta

- „DAO Steering Committee“

to be elected via DAO Governance

- MSig Signers

to be determined in the Phase 3 proposal

- „Arbitrum M&A Mgmt. Co.“

to be led by Areta

Cost

- Set-up cost:

Budget facility of max. $250k USDC (at ARB price to date) to be spent on set-up cost and legal fees (N.b. this will cover all entity and body related set-up topics not covered in Phase 1)

- Operating cost:

$600k ARB per year for a full team of Areta incl. leadership support (matching lower end of current market standard of 0.5 - 2% of assets under management for similar structures, find more details here Arbitrum M&A Mgmt Co. Team Cost). Include management fees and salaries.

- Legal cost:

Budget facility of $250k in ARB per year for dedicated legal and compliance support.

- Transaction fees:

4% of acquisition costs per deal. More pertinent for smaller deal funds, where integration as a percentage of the deal size tends to be higher due to the fixed nature of certain integration expenses. Include: * 3% buy-side advisory success-fee on transaction volume (for investment bank “Arbitrum M&A Unit Mgmt. Co.”)

- 1% legal fees (engaged legal party)
- These success-based costs for completed transactions are on the lower end of market standards (seehere, or here).
- 3% buy-side advisory success-fee on transaction volume (for investment bank “Arbitrum M&A Unit Mgmt. Co.”)
- 1% legal fees (engaged legal party)
- These success-based costs for completed transactions are on the lower end of market standards (seehere, or here).

Total Cost

We estimate the total cost to equal $100-250m in ARB, incl. operational cost detailed below.

This is a two year program and forecasted amounts may require amendments as the program evolves. These amounts will be put up for vote in Phase 3 with sufficient comprehensive data backing them.

Total fund size: $100-250m in ARB

- Earmarked facility to be drawn from per acquisition.

Program Operations: c. $7.5m in ARB

- DAO Steering Committee Members (5):

$50k ARB per member per year ($250k ARB total per year)

- Legal set-up:

$100k (Phase 1)

- Entity set-up:

Max. $250k (Phase 3)

- M&A Unit Mgmt. Co.:

$600k ARB per year

- Legal Party:

$250k in ARB per year (earmarked budget)

- Transaction fees:

3% buy-side advisory success-fee on transaction volume and 1% legal fees. These success-based cost for completed transactions are on the lower end of market standards (see here, or here).

- Multisig Signers (5):

$12k ARB per member per year ($60k ARB total per year)

- Flex Budget:

Remaining amount earmarked for any additional staffing needs, vendors, ops, retro funding, and research.

Initiative Lead

The initiative will be led by a dedicated team from Areta.

We are the leading independent crypto-native investment bank specializing in M&A and complex financial transactions for some of the leading companies and DAOs in the crypto space.

We bring deep transaction expertise, leveraging our experience from prior careers at Blackstone and JPMorgan, which helped us lead complex transactions like the first acquisition of Coingecko or the sale of Solscan to Etherscan.

We have been long-time contributors to Arbitrum's Initiatives and have a long-term vision for the DAO. Relevant experiences include leading the Uniswap-Arbitrum Grant Program and being a member of the ArbitrumDAO Procurement Committee.

VI. Next Steps

The Arbitrum M&A Unit is a space-defining initiative with the aim to act as a key growth driver for the Arbitrum ecosystem and help the DAO expand non-organically through acquisition opportunities that are not accessible for competing ecosystems.

We look forward to your feedback and advancing this further!

Helpful links:

- M&A Working Group
- Working Group on Telegram

VII. Appendix: M&A Target Areas

M&A Ideas for Arbitrum

There are several initial ways in which M&A could act as a key growth driver for the Arbitrum ecosystem (non-exhaustive):

1. Tech Talent Acqui-Hires

Acquire or acqui-hire a team and enable them to focus on building tech for (or otherwise servicing) the Arbitrum DAO. The best opportunities are tier-1 tech teams who need distribution.

There are already examples of this occurring in Web3, one which is close to home for Arbitrum:

- Polygon acquired Mir in Nov 2021 for $400M. Mir's system generates recursive zero-knowledge proofs which results in one of the fastest and most efficient L2 options (see case study). This transaction presents a compelling narrative for Arbitrum: The founders of the Mir protocol had technically built the best ZK chain, but launching a token would likely have led to failure. Therefore, the acquisition was mutually beneficial.

- Offchain Labs bought Prysmatic Labs, one of the core engineering teams behind the Merge, bringing in 11 new engineering talents to the Offchain Labs team.

- Hadron Labs brought Duality Labs to Neutron, an app-chain on Cosmos, as a core team. Hadron Labs allocated 2.5% of the NTRN supply as a long-term incentives package to current Duality Labs members with a 1-year lock and 3-year linear unlock.

Other adjacent examples include: Governance tooling that can potentially be scaled and licensed out to other DAOs (e.g., grants management platform, improved governance portal, etc.).

1. Acquire or Strategically Invest in Complementary Infrastructure / Protocols

Zero-knowledge technology, e.g., could play a large part in Arbitrum's future and strategic acquisitions / investments could accelerate the realization of this vision. Arbitrum can super-charge its entry into the ZK space by acquiring or investing in pioneers in the ZK space, such as Lagrange, Panther Protocol, Herodotus, Ingonyama, or Supranational (these are just examples for illustrative purposes).

1. Acquire L2s

The L2 space is saturated and extremely fragmented at the moment and is only expected to grow in the future. While there are efforts to unify liquidity and enable interoperability across the ecosystem, these will take time to be perfected, and in the meantime, will fragment users and liquidity. With its large treasury, Arbitrum could potentially acquire L2s to unify the ecosystem, grow its user base, and reduce competition and fragmentation in the space.

1. Acquire Applications as L3s for Arbitrum Orbit

Arbitrum is a clear leader in the derivatives and DeFi markets and has made great strides in DeFi generally, while there are 50+ projects currently confirmed to be launching as Orbit chains. However, M&A presents the DAO with an opportunity to identify gaps in the types of applications Arbitrum supports and that it thinks present strategically important use cases going forward in the crypto space - these could range from borrowing and lending protocols, PERP DEXs, NFT DEXs, gaming, etc., and would enable the Orbit ecosystem to scale even more rapidly.

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Target Areas Working Group Exercise

Throughout the operation of the M&A working group, we conducted an initial exercise to define key themes and identify areas of interest as targets. This perspective is intended solely as an additional point of reference. Should Phase 2 be reached, a comprehensive analysis of target areas will be conducted from both strategic and financial perspectives. Additionally, a widespread survey across the DAO will be carried out to further refine these areas.

Find outcomes of the exercise below:

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VIII. Appendix: Background on M&A and opportunity

Motivation

Status of M&A in Crypto

As with every early-stage industry, crypto is incredibly fragmented, with the open-source nature of crypto further adding to this fragmentation. The crypto M&A market is still very nascent, presenting significant opportunities to scale and grow for active market participants. M&A and consolidation is crucial to the crypto space maturing; this trend was seen in the early stages of the technology market as well, and as can be seen in the below chart, M&A is well and truly active across tech today:

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There is a substantial opportunity, moreover, for web2 buyers to enter the crypto M&A space at the moment. As one of the most well-capitalized entities in crypto, Arbitrum DAO would benefit greatly from being one of the first movers. As can be seen below, the time to learn and act is now, before larger/experienced Web2 buyers enter the stage:

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Why Arbitrum Should Consider M&A

Arbitrum DAO has significant potential to be the first movers in this market. Other leading ecosystems have started to explore the opportunity as well (e.g., Uniswap's former discussion which is not moving ahead at the moment), and Polygon has made M&A a cornerstone of its growth strategy.

Several market catalysts are converging currently, moreover, to make this an opportune time for Arbitrum to enter the M&A space now:

- Early Industry Maturation: Early consolidation is evident in older verticals as appetite amongst sector incumbents start to scoop up smaller protocols with great growth potential and lots of users.
- Protracted Bear Market Distress: Following years in the bear market, companies bleed through diminishing runway with private placements in web3 drying up, leading to more distressed sales.
- Buy or Build for New Entrants: Traditional companies looking to enter web3 face the decision of whether to build out their blockchain capacities internally or acquire existing web3 companies.
- Regulation & Compliance: Regulatory compliance across fragmented global jurisdictions has become enough of a barrier that many companies are electing to acquire companies with relevant licenses.
- Acquihire: Many expanding web3 and traditional companies choose to acquire specialized talent, especially sought-after web3 developer talent, by buying out existing companies.

Case Studies

Several protocols have already experimented with M&A. Although not all of the below have led to sustainable success, the case studies provide good insights into some of the dynamics involved.

Polygon's Acquisition of Mir

Polygon acquired Mir in Nov 2021 for $400M. Mir's system generates recursive zero-knowledge proofs which results in one of the fastest and most efficient L2 options. This, along with Polygon's acquisition of Hermez, allowed it to scale its ZK-vision and build solutions like the AggLayer that was recently announced. The acquisition was completely in line with Polygon's strategy of focusing on ZK cryptography as the end-game for blockchain scaling, and is also emblematic of Polygon's complimentary buy-and-build strategy:

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Klaytn & Finschia: The First Blockchain Merger

Klaytn and Finschia are both large L1s in Asia that recently merged in Feb 2024; their combined market cap is ~$887M, with a combined Web3 community of 410K+ members. The merger has allowed Klaytn + Finschia to become Asia's number one blockchain by infrastructure and Web3 services by providing the following benefits:

- Integration of messenger-based Infrastructure and existing Web3 ecosystem
- Burning 23.6% of issued tokens and building a new 3-Layer burning model
- Providing an integrated network environment compatible with Ethereum and Cosmos
- Establishing the largest Web3 governance in Asia and maximizing decentralization

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Fei Protocol's Acquisition of Rari Capital

One of the most infamous examples in the crypto M&A space is when algorithmic stablecoin Fei acquired Rari to vertically integrate their permissionless money market protocol. There was significant controversy around valuation with objective voices agreeing on $RGT holders being underpaid, and the deal left a critical precedent for on-chain M&A.

Since the teams negotiated the transaction parameters themselves, a key takeaway is that specialized advisors could have helped on the questionable valuation and eased communication.

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Key Terms

Definitions of any terms within the proposal that are unique to the proposal, new to the Arbitrum community, and/or industry-specific. This section is optional, but recommended.

Mergers & Acquisitions (M&A)

Mergers and Acquisitions (M&A) involve the process of combining two companies into one or one company taking ownership of another. These transactions aim to create a more efficient and effective entity by leveraging synergies

Target

A target in M&A refers to the company that is being pursued for acquisition by another company, known as the acquirer. The acquisition typically results in a change of control of the target company, transferring ownership to the acquiring company.