Join Sushi for an open Town Hall meeting on 9/21 @ 17:00 UTC to discuss the contents of this proposal - link: https://twitter.com/i/spaces/1zqKVqQkjmWxB

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Abstract

Summary

This post proposes that Arbitrum implement a bond program, created and operated by SushiSwap, in order to build a more sustainable model for creating and managing liquidity that is truly owned and controlled by the Arbitrum DAO.

The Why

Arbitrum has an opportunity to leverage $ARB tokens that would otherwise remain unused in the treasury to instead generate a base of deeper, healthier, protocol-owned liquidity (“POL”) and turn a portion of the treasury into yield-bearing assets.

The How

Through this bond program, a maximum of 12,500,000 $ARB tokens per quarter will be used for bond sales, up to four total quarters. Sushi will sell vesting $ARB tokens at a slight discount to users who purchase the bonds using $ETH-$ARB, $USDC-$ARB, $USDT-$ARB, and/or $wBTC-$ARB LP tokens.

The Outcomes

- Establish $ARB as the central token used to route trades on the Arbitrum network, increasing $ARB liquidity depth, trade volume, and protocol-owned liquidity
- Increase the liquidity depth of blue-chip tokens and stablecoins on the Arbitrum network
- Diversify the Arbitrum DAO treasury with yield-bearing assets
- Generate an initial ~80-90% return on emissions from bond sales
- Achieve break-even within ~450 days, establishing passive income for Arbitrum DAO
- Pass the value created by increased liquidity health on to $ARB holders

Background

Sushi’s team of tokenomics experts has been monitoring and analyzing the fundamentals behind the $ARB token since launch, examining its strengths and weaknesses. After months of tracking trends, Sushi has drawn important insights from a handful of key metrics.

Looking back to the beginning of June, the Arbitrum DAO had a market capitalization (MCAP) of over $1.5B USD, and

upwards of $38,000,000 of buy-side liquidity on-chain. Buy-side liquidity specifically refers to the blue-chips and stablecoins (i.e. $ETH, $wBTC, $USDT, $USDC) that exist in an $ARB pairing. The reason that it is important to look at buy-side liquidity instead of total liquidity is that with the introduction of V3 pools, tokens are no longer paired at a 50/50 ratio, and the buy-side liquidity is ultimately what supports the token price.

Exhibit A

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As of today, only ~$7,870,000 of buy-side liquidity exists for the Arbitrum token, with a current MCAP of ~$1B. This represents a 33% decrease in MCAP and an astounding 80% decrease in liquidity, despite a sideways market. This significant drop in liquidity in comparison to the price depreciation suggests that liquidity providers are taking their capital elsewhere. Additionally, the treasury has been decreasing in value alongside the liquidity profile and MCAP. Without a plan to recoup this huge loss in liquidity and sustainably build toward long term growth, the Arbitrum ecosystem faces even greater risk in the future.

While it is clear that action needs to be taken before this issue gets worse, replacing this $30M loss in liquidity and continuing to build from there would cost the DAO well over $30M in blue-chips and stablecoins. This option may be out of reach, however, what the DAO treasury does have access to is an abundance of $ARB tokens. Sushi believes that this $ARB can be put to work to replace this gap in liquidity with permanent protocol-owned liquidity.

Using tokens from the treasury to incentivise liquidity is not a novel idea; in fact, Sushi originally introduced this now commonly-used farming technique to the DeFi space. These primitive farming and staking methods have seen some improvement in efficiency, but are still widely being used by projects in the same way. Just like the last wave of innovation which caused the first “DeFi Summer”, Sushi is excited to continue the trend of innovation - now with a much more efficient solution, geared to Arbitrum’s specific needs.

Sushi’s analytics team has years of first-hand experience monitoring thousands of tokens in real time, observing best and worst practices on liquidity maintenance. Factors such as market capitalization, volume, and current liquidity should always be considered when determining the ideal state of a token’s liquidity profile. After conducting this research on the $ARB token, estimates suggest that given a ~$1B MCAP, around 1.9% of the MCAP should remain in decentralized liquidity, and 100% of that should be owned by the protocol. This nets to a target goal of 24,068,309 $ARB tokens in POL.

Motivation

This proposal suggests using Arbitrum DAO treasury funds to source liquidity in a sustainable and profitable way, working toward the above POL targets. To achieve this transition, SushiSwap, Arbitrum’s first DEX and a long-standing contributor to the DeFi ecosystem, proposes the adoption of proven bonding techniques. Since inventing liquidity mining in 2020, Sushi has leveraged token incentives to drive growth towards networks and projects; however, this method can only take a protocol so far. While these rewards can attract a few users and spur some growth, the effect is short-lived, leaving projects burdened with long-term costs that outweigh the temporary benefits. The proposed strategy builds upon Sushi’s comprehensive understanding of the DeFi ecosystem and a drive to address the inefficiencies associated with conventional liquidity mining. Sushi’s experience in DEX operations and expertise in sustainable liquidity solutions creates a robust framework for long-term success. These solutions not only remedy the issues of volatile liquidity, but also set the stage for sustainable growth within the DeFi landscape, supporting a healthier and more resilient ecosystem. Passing this proposal will ensure that Arbitrum’s DeFi solutions remain on the cutting edge, leveraging the latest in liquidity fundamental analysis.

DeFi started with simple DEXes and yield farms, but the industry must now shift its focus towards more profitable and sustainable solutions. In traditional finance, a basic concept used to understand profitability is “return on investment”, or ROI. Return on investment measures how much profit an investment generates in comparison to the amount of the initial investment, or simply put, net value generated over costs. This concept is easily transferable to any token economy in DeFi. This metric is called return on emissions, or ROE. One can think of ROE as the actual value that is generated for the protocol in return for each token emitted into circulation. Value can take many different forms (e.g. user acquisition, brand awareness, customer retention, cost savings, market share growth, etc.), but with liquidity provisioning, it’s quite simple: how much liquidity is generated for every dollar worth of tokens emitted?

Return on emissions is one of the most important metrics for any protocol to consider, especially if there are plans to emit additional tokens into circulation over time. Using the example of a simple yield farm, if a protocol were to emit $100,000 worth of tokens to rent liquidity, and the protocol owns no LPs, they do not make a return. This is a true expense with an ROE of 0%, as no financial value is generated for the protocol in return for the extra $100,000 of tokens entering circulation.

Leveraging bonding mechanics, Sushi and Arbitrum can redefine DeFi and massively increase ROE. Bonds offer innovative solutions to create and sustain liquidity for crypto projects of all market caps and use cases, diversifying their treasuries for long term success. Sushi plans to utilize best practices, originally inspired by Olympus, to achieve higher ROE for Arbitrum and its partners and create more profitable opportunities.

Sushi's bonds are quite simple - a protocol sells tokens that vest over time to users at a discount relative to market prices. In exchange, instead of users staking their LPs temporarily, Arbitrum keeps their liquidity provider tokens (LPs). Bonds allow protocols to buy rather than rent liquidity, leading to an initial 80-90% average ROE compared to the traditional 0% ROE generated by yield farming. Using the same example above, if the protocol instead dedicates that same $100,000 worth of token emissions via bonds, it can generate an average of ~$80,000 - ~$90,000 initial return. Sushi's bond program has been fine-tuned for layer 2s like Arbitrum in order to allow them to build robust protocol-owned liquidity. This will be discussed in length throughout this proposal.

The primary benefits of the application of this strategy by the Arbitrum DAO, in collaboration with Sushi, are:

1. Dramatically increase the liquidity depth of blue-chip tokens such as $ETH & $wBTC on the Arbitrum network
2. Increase the liquidity depth of $ARB on the Arbitrum network
3. Diversify the DAO treasury with yield-bearing assets and blue-chip tokens
4. Turn the idle $ARB tokens into a profit center
5. Attract and serve more developers to build on the network

Since launching on block 70, Sushi has been a staunch supporter of the Arbitrum ecosystem, making it the perfect arbiter for this strategy. Sushi is a premier DEX, facilitating over $268 billion of total trade volume, $17 billion of which has been on the Arbitrum network. With thousands of tokens to trade, and one of the most capable bridges enabling transactions from other chains, it's no surprise that over 100,000 users interface with Arbitrum through Sushi each month. This sizable, loyal, and engaged user base guarantees that the Arbitrum bonds offered on Sushi's website will enjoy a substantial and receptive audience. Furthermore, Sushi has received 4.25M $ARB tokens via airdrop, making them a key stakeholder in the DAO's best interest.

Exhibit B

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As highlighted in Exhibit B, it is important to clarify that this proposal does not advocate for distributing tokens without receiving value in return, as seen in the Liquidity Mining section marked in red. Instead, it proposes a calculated strategy whereby a fraction of the treasury is allocated to yield-bearing LP tokens, transforming these $ARB tokens into a source of passive income for the Arbitrum DAO. This approach is projected to generate approximately $6.5 million in profit for the Arbitrum DAO within a two-year timeframe, factoring in three renewals.

Bond Basics and Example

Bonding liquidity offers a superior solution to many challenges typically faced by L1s and L2s, especially when it comes to treasury diversification and sustainably sourcing liquidity for the network and its respective token. Bonding liquidity, when juxtaposed with the extractive and short-lived liquidity mining strategies employed by L1s and L2s in the past, effectively addresses the challenges that these protocols face. As a result, it is a useful strategy for aligning incentives between users and protocols.

In traditional liquidity mining, protocols must spend their own tokens as rewards for users, incentivizing new liquidity into the liquidity pools. Most of the liquidity providers contribute to these yield farms primarily with the expectation of receiving token rewards, as the standard fees for holding most tokens' LPs are minimal. Once these token rewards cease, most of these liquidity providers flee the system in search of other opportunities for yield. Often referred to as 'mercenary miners,' their primary focus is on generating profits, and their engagement is typically fleeting, leaving the protocol vulnerable to rapid fluctuations in liquidity and token price.

For example, consider a hypothetical project named Pineapple, with a native token called $PINA. The following section explores how this project might approach liquidity sourcing through traditional liquidity mining compared to Sushi's innovative bonding approach:

Example 1 - Traditional Liquidity Mining ("The Death Spiral")

1. Pineapple secures a traditional liquidity mining partnership with a DEX or yield farm
2. Pineapple allocates $100,000 USD worth of $PINA to be given away to stakers of the DEX/yield farm token in a staking pool (e.g. a Syrup Pool)
3. For the duration of the pool, the DEX will create a farm where users;

4. Pair $PINA with a blue-chip token (e.g. $BTC, $ETH, etc) or stablecoin to create a $PINA LP token
5. Stake the $PINA LP token into the yield farm to earn the native DEX token

In theory, this would create a cyclical user base, where stakers take the rewards from one staking option, use it to stake into the other, and vice versa - creating a positive feedback loop. While yield farming can temporarily bootstrap large amounts of liquidity, the pitfall with this model is that it requires an unrealistic amount of capital to maintain, which leads to rampant inflation. Since the protocol is spending tokens to source liquidity, but never actually ends up owning any liquidity, it is forced to rent it in perpetuity. This, in turn, puts unnecessary sell pressure on the token, which (all else equal) results in a lower price. As a result of the decrease in token price, token emissions are now less valuable. In order to maintain the same dollar value of rewards and stop users from removing their liquidity, the project has to give away more and more tokens. This process is what industry experts refer to as a “death spiral”, as seen in Exhibit C below:

Exhibit C

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Bonds offer a solution to this “death spiral” challenge. Unlike the traditional method of temporarily renting liquidity from short-term, profit-driven miners, Sushi creates an environment where the protocol can actually buy the liquidity for itself, promoting a positive growth cycle. While this may sound complicated, the process is, in fact, quite simple.

Example 2 - Bonding For Long-Term Liquidity (“The Positive Flywheel”)

1. Pineapple secures a bonding partnership with Sushi
2. Pineapple allocates the same $100,000 USD worth of $PINA to be used for bonds
3. For the duration of the bond sale, Sushi will create a program where users;
4. Pair $PINA with a blue-chip token (e.g. $BTC, $ETH, etc) or stablecoin to create a $PINA LP token
5. Trade the $PINA LP token for single asset $PINA at a discount to the spot price
6. The tokens purchased at a discount are then wrapped and placed inside of a bond NFT minted to the end user
7. The discounted tokens can be claimed from the bond NFT according to their vesting schedule

This way, the Pineapple protocol is able to receive a financial return on the tokens they spend on liquidity mining, as opposed to giving them away for free to those that are providing liquidity temporarily. One of the primary benefits is that bonding products see an average initial ROE of 80-90%. In other words, for every $1 of tokens a protocol invests they are receiving about $0.85 of liquidity in initial return. Compared to the ~0% ROE that a protocol receives in traditional liquidity mining, this approach is unquestionably more beneficial.

When a protocol owns their liquidity, they are able to kickstart a positive flywheel with numerous benefits. As seen in Exhibit D below, the process is straightforward, and once it begins, it is easy to continue. It all starts with the protocol taking their liquidity health seriously by initiating the journey towards owning their own liquidity.

To achieve this, protocols can utilize bonds to sell their native tokens in exchange for LP tokens. This causes the liquidity pool for the native token to permanently deepen, because the liquidity is now owned by the protocol and earning trading fees. In tandem, the protocol’s community is strengthened as the token itself is more liquid and they can trade it with less slippage. A stronger community leads to organic marketing, which leads to growth as a larger user base becomes interested in the token. The protocol can “rinse and repeat” this process, allowing the treasury, community and the liquidity to grow simultaneously.

Exhibit D

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Bond Program Rationale & Benefits

Thanks to substantial funding and a robust user base, Arbitrum’s unique position offers the potential to scale to new heights

in the Web3 space. By leveraging bonds on Sushi, the Arbitrum DAO will be able to accomplish the following:

1. Dramatically increase the liquidity depth of blue-chip tokens such as $ETH & $wBTC on the Arbitrum network
2. Increase the liquidity depth of $ARB on the Arbitrum network
3. Diversify the DAO treasury with yield-bearing assets and blue-chip tokens
4. Turn the idle $ARB tokens into a profit center
5. Attract and serve more developers to build on the network

This benefits the overall ecosystem by aligning incentives between the Arbitrum DAO, $ARB holders, and those building on the network itself. In short: everybody wins. The DAO wins because it is able to diversify its overexposed $ARB holdings while strengthening $ARB liquidity. The token holders win because they are able to either hold an asset with deeper liquidity and stronger price support, or leverage bonds to accumulate a larger amount of tokens at a discount. Protocols building on Arbitrum win because they are able to gain access to these same liquidity mining strategies by working with Sushi.

By diversifying the treasury with $ARB-based LPs, Arbitrum DAO turns the $ARB tokens into yield-bearing assets. LP tokens accumulate trading fees over time, automatically growing the LP position, and as the TVL on Sushi grows with this strategy, the trading fees received by Arbitrum will increase as well (as shown in Exhibit E). Passing this proposal will lead to the Arbitrum DAO becoming the largest individual provider for blue-chip $ARB token pairs on the network. With that, what may start out as an 80% - 90% ROE will eventually exceed 100% due to the yield that the LP tokens will generate, as displayed in Exhibit F.

Exhibit E

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Exhibit F

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The Natural Demand of Bonds vs Yield Farms

In this context, a key question arises: What happens to $ARB tokens if bonds go unsold? The answer is simple - Arbitrum reclaims all unsold tokens, resulting in no impact. Bonds entail minimal risk compared to yield farming.

In traditional yield farming, smart contracts distribute tokens based on staked assets. For instance, if a farm has $1,000,000 in token incentives for a month, and only $1 in LPs is staked, that provider receives the entire $1,000,000. Bonds, on the other hand, reward tokens only when a user purchases a bond. $ARB tokens incentivizing liquidity enter circulation only when users contribute enduring value to the ecosystem.

For a concise summary of bonding advantages over yield farming, see Exhibit G below.

Exhibit G

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The Expected Outcome

According to extensive analysis, the expected outcomes are: all available Arbitrum bonds net an 85% average ROE (or higher), the value of the LP tokens accumulate trading fees to generate over a 100% return, and the entire program becomes profitable in approximately 450 days assuming all KPIs are met. If all prices of assets stay constant, Arbitrum will get more value out of the program than it puts in, establishing an extremely stable liquidity foundation for the $ARB token, diversifying the treasury with a yield-bearing asset and setting up the token for the positive flywheel.

Achieving the Expected Outcome

Sushi is confident Arbitrum can achieve the expected outcome. Step one will be leveraging the $ARB tokens that the Arbitrum DAO has set aside to help grow the network by bonding them in exchange for $ETH-$ARB, $USDC-$ARB, $USDT-$ARB, and $wBTC-$ARB pairs, according to the table below. These bonds will be available for purchase on Sushi's website, and the LP pairs acquired through the sale of those bonds will serve as the foundation upon which Sushi builds its entire DEX liquidity on Arbitrum. Placing $ARB as the central routing token will aid in providing a more stable floor price for $ARB in addition to stimulating volume by creating more efficient trading pathways. Simply put, more trades will be routed through $ARB than any other token. This construct is illustrated in Exhibit H below, emphasizing the core focus of the $ARB token.

Exhibit H

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Sushi selected these pairs based on which ones had the highest liquidity-to-volume ratio across all DEXs on Arbitrum, and they can be adjusted up or down based on real-time data. This proposal will have a bootstrapping effect on Sushi for Aribitrum, further establishing Sushi as a multi- and cross-chain liquidity hub for all of DeFi. The Sushi team is actively building infrastructure to scale that model. Note: these POL targets are based on the current price of $ARB at the time of posting, and may fluctuate with market conditions.

As part of this proposal, Sushi will make ongoing bond progress analysis available before the start of each quarter to optimize $ARB token allocations and meet the goals outlined above. This means that instead of assuming success and allocating the full amount all at the beginning, the first installment will begin with 12,500,000 tokens, adjusting each sales period based on real time data. Public status reports will be provided by Sushi so that anyone can track the progress towards the goals specified within this proposal.

As noted in Exhibit H above, Sushi's analysts purposely place $ARB as the center of the ecosystem's trade routing. As a result, all bonds are paired with the $ARB token, allowing for an $ARB token clawback on every pair. These bonds claw back up to 50% of the $ARB tokens emitted, depending on the ROE. This clawback rate refers to the amount of $ARB tokens emitted vs. $ARB tokens returned through permanent protocol-owned liquidity. Using the average ROE of 80-90%, Arbitrum would retain approximately 40-45% of $ARB tokens emitted as POL, with the other 40-45% coming back in the form of blue-chip tokens and stablecoins. This results in the Arbitrum Foundation clawing back almost half of the ARB tokens allocated to this proposal into permanent liquidity.

For example, with an average ROE of 85% on a $100,000 budget for bonds, a project would expect a return of ~$85,000 in liquidity. That $85,000 in liquidity would typically hold $42,500 of each token within the pair; therefore, the protocol would average a token emission clawback of 42.5% per bond sale. With traditional liquidity mining, the average token emission clawback is ~0%, because no tokens are taken out of circulation.

With this in mind, the proposed $ARB allocation of 12,500,000 per sales period will only result in an increase of 7,187,500 tokens in circulation, whereas the remaining tokens will be clawed-back into the LP pairs being bonded. Over the course of one year, this will result in a token emission clawback of approximately 21,250,000 $ARB tokens into the LP. When factoring in naturally occurring LP trading fees (see projections section below for a deeper explanation) the clawback increases to approximately 26,500,000 $ARB as shown in Exhibit I below.

Sushi takes an analytical approach when it comes to bond programs to ensure a premium result; and the 12,500,000 $ARB token allocation per sales period comes from this comprehensive analysis. As noted above in the example using an 85% return, Arbitrum would net 21,250,000 $ARB tokens in DeFi liquidity after four consecutive sales periods, getting very close to the current goal of 24,068,309. An important factor to keep in mind is that a stronger liquidity base sets the stage for price appreciation through the positive flywheel. As the price of the token increases, the MCAP naturally follows, thus the $ARB POL target mentioned above would grow as well.

Exhibit I

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Success Fee

Sushi stands poised to reap the rewards of every bond sale's success through a dynamic success fee structure, mirroring

the familiar approach seen in conventional capital fundraising. While the traditional financial landscape often imposes fees that can soar as high as 20%, Sushi takes a more investor-friendly stance with a modest 5% success fee. This alignment of incentives between Sushi and Arbitrum underscores the shared goal: to strategically amass the maximum amount of protocol-owned liquidity with the highest possible efficiency. The success fee contributions from LPs will accumulate securely within a dedicated multi-signature wallet on the blockchain. It is worth highlighting that these fees are applied after bond sale collections (i.e., they do not come off the top).

Projections

The end result of this proposal is the addition of LP tokens into the Arbitrum DAO treasury. LP tokens are yield-bearing assets that naturally accumulate trading fees within them. For example, Sushi's DEX operates with a standard 0.3% fee on every swap, of which 83.3% is reinvested directly into the liquidity pool tokens themselves, causing them to grow in value over time. Since these assets will grow, the Arbitrum DAO will eventually achieve above 100% return on this proposal! Based on the analysis, it is projected that the Arbitrum DAO will break even and turn profitable in ~450 days assuming all KPIs are met.

The following constants were used to determine the above projections::

1. No price fluctuation of the $ARB token
2. All market data for the $ARB token was taken into consideration except the first 10 days of the token's history, as new tokens typically see above average volume
3. The bonded LP tokens are not unpaired and continuously accumulate trading fees
4. A net 85% ROE is achieved.

Exhibit F above and Exhibit J below outline the break-even point and demonstrate how the Arbitrum DAO stands to turn the allocated $ARB tokens into a profit center.

Exhibit J

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KPIs and Milestones

To ensure quantifiable measures of performance the following is proposed:

Strategy Alignment:

- Structured approach to governance renewals to streamline the process when success is proven via a predefined KPI
- Flexible for up to three renewals of 12.5 million $ARB tokens each, one every three months or when the previous allocation is depleted

Key Performance Indicators (KPIs):

- Maintenance of a minimum gross Return on Emissions (ROE) of 80% throughout the sales period.
- ROE is assessed at the time of each individual bond sale, and independent of price volatility.

Controls and optimization:

- Active oversight of liquidity profile and bond performance.
- Initial configurations completed no more than 48 hours before deployment.
- Status update a week before the sale is expected to end with all relevant data and next sales period's requested allocation.
- Variables such as Bond Control Variable, Max Debt, and Max Payout adjusted for optimal bond configuration and ROE enhancement.
- Vesting periods for bonds considered in performance evaluations.

Process

1. This proposal is approved by Arbitrum DAO voters
2. A multi-signature Safe (formerly Gnosis Safe) wallet will be created to hold the initial 12.5M $ARB tokens that will be controlled by multiple key stakeholders including Arbitrum DAO and Sushi
3. Based on initial configurations, a portion of the total allocation of 12,500,000 $ARB tokens will be added to the bond treasury smart contract, topped up as needed.
4. Multiple bonds will be set up, each plugging into the treasury contract to facilitate bond sales for different pairs
5. Arbitrum's net proceeds from each sale will be instantly distributed back to the treasury wallet, configured and hard coded on-chain.
6. One week before the three month sales period ends, a status update will be posted with all relevant data tracking the success of the program compared to the KPI.
7. If KPIs are hit, additional $ARB tokens will be released to the multisig and the process will start again.
8. If KPIs are not hit, unsold tokens will be returned to the Arbitrum DAO treasury and the program will stop.
9. This process will be repeated until the renewal cycles have been completed.

Conclusion

This proposal marks a pivotal step in Arbitrum's evolution. Shifting from traditional liquidity mining to sustainable bonding diversifies the DAO treasury with yield-bearing assets, while deepening liquidity pools. This aligns incentives among the protocol, token holders, and builders, ensuring a win-win outcome.

Introducing return on emissions (ROE) emphasizes the value generated by each emitted token. Unlike traditional liquidity mining, Sushi's bonding method allows the protocol to purchase and own liquidity, resulting in a significantly higher ROE. This shift from a "death spiral" to a "positive flywheel" approach is vital for long-term sustainability and growth.

Strategically positioning the $ARB token as the central routing token enhances price stability and trade volume. A stable floor price and increased trading volume boost ecosystem growth and sustainability. The Arbitrum DAO is projected to break even and become profitable in ~450 days, thanks to LP tokens accumulating trading fees.

The proposal outlines a transparent process, including token allocation sales reports, adapting to real-time data and market conditions, minimizing risks, and maximizing potential.

Passing this proposal ushers in a new era of sustainable and profitable liquidity solutions for Arbitrum. It paves the way for continued growth, community benefits, and enhanced token value, establishing Arbitrum as a DeFi leader. Arbitrum DAO and SushiSwap are set to shape decentralized finance's future, and your support is crucial to realizing this vision.

Exhibit K

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