Tldr, the goal of this post is two-fold:

1. Raise awareness of what I believe is the best long term value proposition for COW: make more in fees than we spend in cost and distribute that profit to token holders

2. Bootstrap a discussion around how we as a community see the trade-off of being profitable now vs issuing tokens as means to bootstrap network effects

Given some of the recent discussion around the increased sell pressure and long term value proposition of the $COW token, I wanted to take a moment to post my thoughts on the matter.

I personally don't share the belief (which I recently saw repeatedly on Twitter and from speaking to people) that the long term value of the token will come from fee subsidies for traders nor deferred locking mechanisms to reduce immediate sell pressure (I'm also not strongly against either as a short term incentive, but I feel they will have little impact on the fundamental value of the protocol).

While the decision on how to run the protocol is ultimately up to the DAO, I think COW Protocol can run a very simple business model. It generates revenue by charging users a fee on each trade (for users' convenience in the sell token). Up until today the protocol has earned more than $15M in fees. Last week alone it earned >$330k in fees.

At the same time, the protocol has costs. It refunds its solvers the gas they spend for settling orders and also pays a 100 COW reward for each settlement. Today, the cost of the protocol mostly exceeds the revenue it makes (it is operating at a loss). However I think that in the long term the revenues can be much larger than the operating costs. At this point, it should be straightforward to capture value for COW token holders by implementing a simple buy-back or dividend payout scheme.

How can we get there? In theory, the DAO could turn the protocol profitable today. Since revenue and costs are quite detached in our architecture (compared to other DEXs where users pay their own transaction cost) we could increase the amount of trading fees we take on each order beyond our expected execution costs (users may be willing to pay for other factors like trust in the platform, paying their fee in sell token, MEV protection, not failing for failed transactions, chance of price improvement via a COW).

Currently, we deliberately charge less than the expected gas costs. The idea behind the discount was to reduce some of the fixed gas overhead that comes from the added batching layer and in order to bootstrap adoption. This decision was made, because another key aspect of CoW Protocol is its extremely strong network effects both for gas costs as well as price improvements: Matching a single user order via Cow Protocol is on average more expensive than going to Uniswap directly (due to the intermediate settlement layer that performs a signature check + extra transfers). However, executing multiple trades in a single transaction can be much cheaper than executing them individually. Dune shows plenty of batches in the last month where the average gas cost per trade was below 100k - a significant improvement compared to current DEXs. If most batches looked like that, the protocol would be more gas efficient than its competition.

This trend can also be seen if we look at the average gas cost per trade vs gas cost per batch, we can see that as the "gas per batch" increases (batches getting more crowded) "average gas per trade" stays constant and even trends down.

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I therefore believe that given enough users we could even sustain the current fee subsidy while eventually being profitable. However, this would require liquidating more tokens in the short term.

Maybe there are other ways to bootstrap the network effect? Maybe, instead of giving users a subsidy on the fee we should use CoW tokens directly for a trading incentive program? Should we strive to make a small profit already today and demonstrate a buyback program with the return? Or would this stifle growth and usage too much?

I'm looking forward to input and thoughts from the CoW-munity.