

DeFi (Decentralized Finance)

After the 2008 financial crisis, a wave of fintech startups began to provide financial products and services to a more tech-savvy generation that was disgruntled with the legacy banking sector. Mobile banking apps, peer-to-peer lenders, cheap payment and money transfer solutions emerged. While many of these products have clear advantages over legacy banking solutions, they represent incremental improvements, not a financial revolution. Now a new wave of blockchain-based DeFi projects are attempting to kick start the financial services industry revolution that “traditional” fintech startups have failed to deliver.

Bitcoin pioneered what we now know as decentralized finance before the term “DeFi” entered the lexicon. Bitcoin was the first decentralized, open-source digital payment method that enables everyone to be their own bank. However, in late 2019, the constantly evolving crypto narratives have shifted. For now, Bitcoin is leaning towards becoming a store of value as ‘digital gold’. The ability to use Bitcoin as a simple medium of exchange at scale will come in the future via layer two payment rails such as the lightning network. Meanwhile, Ethereum is moving away from the ‘world computer’ narrative and is increasingly thought of as a hub for the nascent DeFi ecosystem. Decentralized lending protocols, trustless derivatives trading, and the tokenization of assets are just some of the innovations made possible by blockchain-powered smart contracts. Decentralized financial applications enable anyone across the globe with an internet connection to gain access to basic financial services, such as borrowing and lending. Something that no legacy financial institution or fintech startup has managed to achieve.

When fintech solutions first appeared on the scene they generated considerable excitement and VC funding attracted by the promise of user-friendly interfaces, reduced bureaucracy, wider choice and lower fees. Mobile banking apps, peer-to-peer lending marketplaces, and low-cost online money transfer platforms quickly managed to gain a foothold in the market, especially with millennials and younger. In one sense, there was a “fintech versus the banks” feel to the blossoming financial technology industry in the early years. Many idealistic fintech entrepreneurs thought they could take on the banks and beat them at their own game. A significant number of fintech startups have become or are on their way to becoming banks. Every fintech company is just a disguised strategic growth hack where the real goal is to become a bank. Some examples, Revolut which started as a multi-currency prepaid card and has obtained a banking license in 2018. Robo-advisor Betterment, which added FDIC-insured checking and savings accounts to its offering, and P2P lender Zopa, which also received its banking license in 2018, among others. While there is nothing wrong with a fintech startup obtaining a banking license to expand its business, it begs the question, where is the innovation, where is the revolution?

With a banking license comes the same regulatory restrictions and red tape that are holding back banks from providing innovative, accessible financial products and services. Conversely, decentralized finance may be the innovation that is missing in today’s financial services sector. The ability to provide decentralized financial services to anyone in the world with an Internet connection could revolutionize the financial industry in a never-before-seen manner.

If someone located in an emerging market with no access to traditional banking, can log into a DeFi platform and borrow in a stable-coin to expand their business and then repay the loan, there would be no need for a bank. If the same person could then send money to family members across borders on a peer-to-peer basis, there would be no need for a bank. If someone could invest in tokenized assets or stake coins to earn interest while remaining in complete control of the funds, there would be no need for a bank.

Currently, the Defi sector operates almost exclusively on the Ethereum network. Fortunately, for the Ethereum community and ETH “HODLers”, the rise of DeFi could drive interest (and value) back to the battered blockchain project lead by Vitalik Buterin. Leading Ethereum-based DeFi projects with their own ERC-20 token include Augur, Gnosis, Kyber Network, Maker, and Ox. Whether DeFi will largely remain “an Ethereum thing” or whether the market will move to another, more technologically advanced blockchain will remain to be seen. Can the innovations found in the DeFi market become more disruptive than what the “traditional” fintech sector has to offer? As of now, the only barriers standing in the way are the same barriers found across the blockchain space - scaling, capacity and usability.