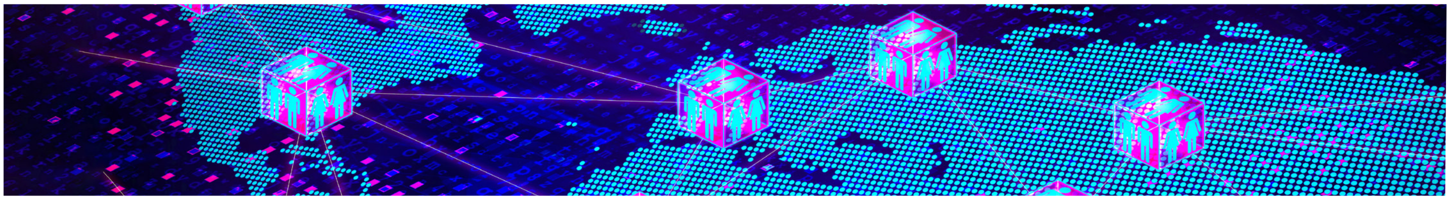
# DAOs: The Biggest Corporate Innovation Since Limited Liability?



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## KEY TAKEAWAYS

- Digitally native DAOs have the potential to upend the corporate structural paradigm
- DAO Tooling is a sub-sector of software providers that are creating the resources DAOs need to operate efficiently
- Growth potential is balanced with regulatory, market, operational and execution risk

As a burgeoning construct, certain industry participants believe that decentralized autonomous organizations, or DAOs, may be the biggest innovation in corporate structures since the introduction of limited liability.

Before that, company owners were generally responsible for losses incurred by a customer, and the owners' personal assets were at risk along with their investment in the company. This meant companies tended to be highly risk averse and were more likely to be small partnerships between trusted individuals such as family.[1]

The ability to protect the personal assets of investors in railroad construction, shipping, or other companies against losses caused by their operations substantially changed the relationship of owners and the ability of companies to fundraise. Rebalancing the connection between risk and reward gave companies more freedom to scale at levels that were not practical under the unlimited liability model. Being able to raise significant capital from a wide range of investors generated an investment boom that turbocharged the economic development of states and countries that had formalized limited liability ownership.[2]

DAOs may be the next iteration in the evolution of organizational structure. Because DAOs can have unlimited members all over the world and no specific geographic location, existing only in the cloud, their structure isn't a natural fit for regulatory oversight frameworks based on boundaries such as states or countries. DAOs therefore have the potential to create significant economic disruption, just as previous versions of the corporate structure did.

Definitionally a DAO is a digital native entity where decisions are made by a community that is organized around rules embedded in software and enforced by the associated blockchain. DAOs run as code and are governed (i) by tokens that are owned by the members, and (ii) by smart contracts, which are programs stored on a blockchain that run when prescribed conditions are met.

DAOs can form for any purpose. A DAO could be a global network of freelance coders or creatives who pool resources to buy software licenses, share intellectual property, and decide on who should fulfill various assignments. Or it could be a venture firm where disparate members vote on investment opportunities to be funded with resources in their treasury.

DAOs can also be formed as special purpose vehicles. For example, in late 2021, ConstitutionDAO raised $49.8 million[3] in Ether in a week to purchase a rare first edition copy of the US constitution, but was outbid at a Sotheby's auction and is now returning the funds to members.

## Unique Structure

On the surface, DAOs formed for economic purposes can look like a regular, analog company. However, they function fundamentally differently. There is often no headquarters, no chief executive officer, no management, no employees, no articles of incorporation, and therefore no regulated nation boundary.

This unique organizational and operational structure gives DAOs the potential to significantly disrupt commerce. Take insurance as an example.

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## Insurance, Real Estate

Thousands of years ago in places such as China and Babylonia, groups of farmers would divide their harvest between multiple river barges or ships so that, if one sank, they each lost only a portion of their crop.

This collectively managed insurance model is being updated for the Information Age by Nexus Mutual, which uses smart contracts on the Ethereum blockchain to create and build a peer-to-peer insurance mutual.

"Through the use of membership tokens, blockchain technology can bring back the original goals of the mutual where all contributions are entirely for the benefit of members," Nexus Mutual says on its website. "Aligned incentives will foster a community spirit rather than the existing adversarial and unbalanced relationship between individual and large institution."[4]

Real-estate finance is also being disrupted by DAOs. Founded in 2015, MakerDAO enables transactions using a stablecoin created on the Ethereum blockchain called DAI that is anchored to the US dollar. In late March 2022, 6s Capital, a lender using the MakerDAO protocol, closed a $7.8 million deal with Tesla that the biggest maker of electric vehicles will use to build a collision repair center. The credit line is expected to increase to $14.2 million later this year.[5]

## Venture Capital

Another example of a financial use case is DAOs that resemble directed venture capital funds.

Digitally native funds allow members to pool capital, invest in projects, and share in any proceeds from an investment. This is similar to a traditional venture vehicle, but with the notable distinction that the funds are entirely member directed and managed, and almost exclusively focus on blockchain-based projects.

As we are still very early in the industry, we expect many new use cases for DAOs to emerge in coming years. We are therefore also interested in the infrastructure that will underpin DAO formation and operations.

**The unique structure of DAOs requires a new set of software tools to facilitate effective community engagement, and to efficiently manage processes such as payments**

## DAO Tooling

The unique structure of DAOs requires a new set of software tools to facilitate effective community engagement, and to efficiently manage processes such as payments, token formation and governance, treasury management, security, and systems integrity.

As such, many companies are forming to service DAO-specific needs. Coinvise is building tools that use social tokens with the aim of helping creator communities to win and manage projects, and work in collaborative ways.[6] Snapshot Labs[7] is building voting and governance solutions for DAOs, while Coinshift simplifies treasury management by providing efficient multisignature tooling.[8]

## Potential Risks

While an exciting corner of the blockchain ecosystem, the upside potential of DAOs is balanced by regulatory, market and execution risk. A key operational risk for DAO tooling providers is that their customers can simply cease operations – as seen with ConstitutionDAO, which disbanded after it lost the US constitution bid.

That said, DAOs have the potential to revolutionize value creation while reducing organizational friction. Anyone with access to the web can now build a community of people with a shared goal or vision, which can work collaboratively to create a digitally native organization run entirely on code that could reach global scale. Risks notwithstanding, it’s a prospect that is difficult to ignore. ■

1. Source: **The History of LLCs, The Complete History of the LLC**
2. **https://www.economist.com/business/2016/09/29/dont-limit-the-revolution**
3. Source: "Almost buying a copy of the Constitution is easy, but giving the money back is hard" **The Verge November 24, 2021**
4. **https://nexusmutual.io/assets/docs/nmx_white_paperv2_3.pdf Page 2 second column.**
5. **https://thedefiant.io/tesla-makerdao-loan/**
6. **https://coinvise.notion.site/How-Creator-DAOs-redefine-the-way-we-work-21c3f7b601b841629ba8de3761451a95**
7. **https://snapshot.org/#/**
8. **https://coinshift.xyz/**

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