

Welcome to Morgan Creek Digital's weekly digital asset update. It is comprised of a thought piece from our team followed by a summary of what we consider the most compelling digital asset news during the last week. We hope you find this content interesting. Please let us know if you have any comments or questions or if you would like to speak to a member of the [Morgan Creek Digital team](#).

### **A Dual View of Diligence: How Diverse Thought Leads to Better Outcomes**

In an introduction to statistics course, you are likely faced with the decision to accept or reject the null hypothesis ( $H_0$ ). To reject the null, you need new information that directly contradicts the original assumption, known as the alternative hypothesis ( $H_a$ ). Likewise, the Morgan Creek Digital (MCD) internal investment team is tasked with carefully combing through available data on a potential investment to challenge the initial hypothesis provided by the startup, their clients or fellow investors. We believe that the process of challenging our initial assumption and implicit biases drives better outcomes.

Due diligence is a comprehensive appraisal of a company before making an investment. While the due diligence process may seem less glamorous than just quickly selecting the next market disruptor at a demo day, a venture capitalist runs a significant risk of missing market opportunities without a systematic process. Our initial approach focuses on evaluating the market, team, product, and deal. More specifically, our due diligence process typically includes speaking with clients and investors, individual research, product/demo testing, customer user interviews, extensive backchannel references, and more. In addition, the MCD team views the process of due diligence as an opportunity to highlight diversity in teams and leadership.

#### **Our Pillars of Due Diligence**

**The Market:** This entails an in-depth evaluation of total addressable market and growth opportunity, as well as the market fit within the competitive landscape. Our knowledge of blockchain intelligence leverages both public and internal data from portfolio and non-portfolio companies to enhance our understanding of changing markets.

**The Team:** This includes evaluating the current leadership, broader teams and advisory board members. In particular, we are interested in assessing the team's competitive advantage, domain expertise, business relationships, past functional experience and execution (prior exits). We also look for gender and ethnically diverse leadership teams, which we believe increases debate and diversity of thought.

**The Product:** This involves an analysis of product-market fit. We evaluate a company's approach to addressing the problem or market opportunity. Additionally, we look at the scale and scope of the business idea, business model, and underlying assumptions to attempt to map the current and future growth metrics.

**The Deal:** This analyzes investment metrics such as an equity position, round stage, investment size, ownership percentage, valuation, projected return and exit

possibilities. A deal can fall apart at the wrong size as both investors and entrepreneurs may jeopardize success with a target too big or small.

**Additional:** When diligence begins to narrow, our team looks at other risk areas. This can include financial, technical, legal and regulatory risk. Financial risk evaluates traction to date, projections, funding strategy, terms, strategic partnerships and more. Technical risk considers product dependencies needed to launch or scale. Legal reviews evaluate incorporation documents and corporate activities -- such as those related to directors, intellectual property, assets and liabilities, liquidation preferences, and contracts and may also include considerations related to taxes, laws and regulatory environments.

MCD uses its due diligence process to evaluate the plausibility of assumptions and to accept or reject the null hypothesis. However, financial projections, market plans, and even a company's offering are all subject to the inevitable ebb and flow of the market. No matter how compelling a founder's vision is, exogenous threats are difficult to model. For this reason, the strength of the management team and their ability to adapt is pivotal to success.

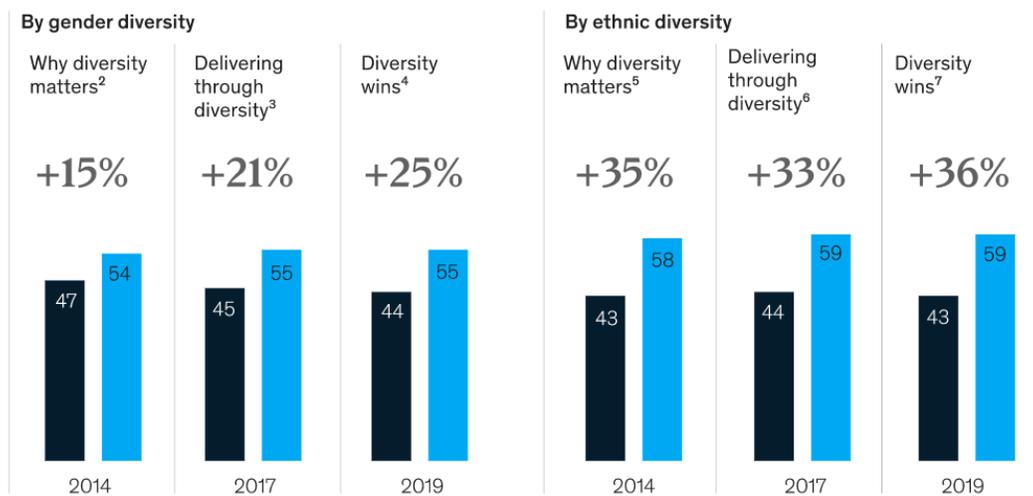
### **Diversity of thought, leadership and people**

*"Failing to recognize implicit biases blinds us to better decision-making and robs investors of their returns. Is there a fix? I think so, and it begins with not being afraid to surround yourself with people who don't look like you and empowering them to make decisions."*

- Xavier A. Segura, General Partner

Diversity manifests itself as a strength in numerous ways throughout the diligence process. The structured approach of challenging our assumptions naturally exposes us to diverse perspectives. MCD seeks to invest in companies led by diverse leadership teams, which we believe creates value. For example, a 2019 [McKinsey report](#) found that companies in the top quartile for ethnic and racially diverse management were 36% more likely to generate financial returns above their respective industry average. Furthermore, companies in the top quartile for gender diverse management were 25% more likely to have returns above the industry average. More specific to VC, the *Journal of Financial & Quantitative Analysis*, after analyzing VC investments in nearly 10,000 companies across 30 countries, found that cultural distance between countries of the portfolio company and its lead investor(s) resulted in a positive outcome for VC success.<sup>1</sup>

*The Business Case for Diversity in Executive Teams Remains Strong: Source McKinsey & Company*



<sup>1</sup>Likelihood of financial outperformance vs the national industry median; p-value <0.05, except 2014 data where p-value <0.1. <sup>2</sup>n = 383; Latin America, UK, and US; earnings before interest and taxes (EBIT) margin 2010–13. <sup>3</sup>n = 991; Australia, Brazil, France, Germany, India, Japan, Mexico, Nigeria, Singapore, South Africa, UK, and US; EBIT margin 2011–15. <sup>4</sup>n = 1,039; 2017 companies for which gender data available in 2019, plus Denmark, Norway, and Sweden; EBIT margin 2014–18. <sup>5</sup>n = 364; Latin America, UK, and US; EBIT margin 2010–13. <sup>6</sup>n = 589; Brazil, Mexico, Singapore, South Africa, UK, and US; EBIT margin 2011–15. <sup>7</sup>n = 533; Brazil, Mexico, Nigeria, Singapore, South Africa, UK, and US, where ethnicity data available in 2019; EBIT margin 2014–18. Source: Diversity Wins data set

McKinsey  
& Company

**Conclusion:** Good deals are not always easy to identify, but they can sometimes seem evident after an exit event occurs. While success can be driven by product-market fit or a superb management team, luck and timing can also play an outsized role. Our job as investors is to methodically conduct rigorous diligence and challenge our biases and assumptions as we aim to catch growth waves and make successful investments.

## THE RUNDOWN:

**Two Senators Propose Exemptions to Crypto Tax Reporting Required by U.S. Infrastructure Bill:** U.S. Senators Mark Warner (D-Va.) and Kyrsten Sinema (D-Ariz.) recently updated their amendment modifying a crypto tax reporting provision in the Senate’s landmark infrastructure bill. The original amendment, introduced late last Thursday, would exclude cryptocurrency miners who are involved in validating transactions on distributed ledgers and companies that are selling private key hardware or software wallets. [Read more.](#)

**Washington Wakes Up to Crypto Influence Amid Infrastructure Fight:** An intense infrastructure bill brawl between Bitcoin advocates, Congress and the White House has revealed a new power player in Washington that’s starting to find its footing: the cryptocurrency lobby. The industry was first caught off guard when lawmakers and the Biden administration targeted it with new tax rules tucked into the bipartisan Senate infrastructure bill announced last month. But it fought back with a vengeance, showing that startup digital trading platforms and other firms could rally a small army of recently requisitioned trade associations, lobbyists and public relations experts to put up a real defense. [Read more.](#)

**The Sacking of a Crypto Mecca (long read):** The creator of America's crypto mecca: Ian Freeman saw cryptocurrency as a kind of moral crusade against the belligerence of the U.S. government. He is best known as the host of Free Talk Live, a libertarian talk radio show syndicated to 185 radio stations across the country. His show became a

gathering point for the early Bitcoin community, turning the small town of Keene, N.H. into a crypto mecca. In March of this year, federal law enforcement raided the crypto oasis, tearing it down and arresting six people. The story is much more complicated than it seems. [Read more.](#)

**Jack Dorsey Says Bitcoin Will Unite the World:** Twitter and Square CEO Jack Dorsey, a noted super fan of Bitcoin, claimed on Monday that the cryptocurrency will eventually unite the world. On Monday afternoon, an amendment to the Senate’s infrastructure package that would have expanded the government’s involvement in cryptocurrency was blocked. Shortly after that, Dorsey tweeted that “#Bitcoin will unite a deeply divided country. (and eventually: world).”

**PNC Bank Is Planning a Crypto Offering With Coinbase:** Coinbase said last Tuesday that it’s working with PNC Bank, the fifth-largest bank in the U.S., on a previously undisclosed crypto project. “In recent months, we have formed partnerships with industry leaders including Elon Musk, PNC Bank, SpaceX, Tesla, Third Point LLC, and WisdomTree Investments,” the shareholder letter read. When asked by CoinDesk, Coinbase declined to elaborate. [Read more.](#)

**Coinbase Rakes In \$1.9B in Transaction Revenue in Q2, Beating Estimates:** Coinbase posted \$1.9 billion in transaction revenue in the second quarter, in its second-ever earnings report as a public company. Analysts had estimated the exchange would post \$1.57 billion in transaction revenue. The U.S.’s largest cryptocurrency exchange grew to 8.8 million monthly transacting users (MTUs) and 68 million total users in the quarter, versus analyst estimates for 6.7 million monthly users and 62.8 million total users. The exchange’s take rate – or retail trading revenue divided by retail trading volumes – was 1.24%, up from 1.21% last quarter. [Read more.](#)

<sup>1</sup>Nahata, R., Hazarika, S., & Tandon, K. (2014). Success in Global Venture Capital Investing: Do Institutional and Cultural Differences Matter? *Journal of Financial & Quantitative Analysis*, 49(4), 1039–1070. <https://doi-org.ezproxy.rollins.edu/10.1017/S0022109014000568>

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