“What the crypto crash teaches us all”

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MICHAEL GRONAGER: Everything moves faster in crypto. That's how it is.

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And maybe the first steps into crypto that's similar. So I think we are early in the phase today. Every company will become a crypto company, and it will change the world.

BOB SAFIAN: That's Michael Gronager, the founder and CEO of Chainalysis, a company that gathers intelligence on digital assets in the cryptocurrency space, monitoring $1 trillion in transactions every month.

Just this spring, Chainalysis raised $170 million at an $8.6 billion valuation.

I'm Bob Safian, former editor of Fast Company, founder of The Flux Group, and host of Masters of Scale: Rapid Response.

I wanted to talk to Michael because, after enthusiasm about cryptocurrency soared last year, we're now in a full-on crypto winter.

And it can be confusing to understand where crypto fits in business strategy and how it might really impact the future of finance.

Michael has been a crypto insider for a decade, and offers straightforward explanations around the risks and opportunities faced by businesses, society, and his own company.

Chainalysis is like a private watchdog in the crypto space, chasing down bad actors for law enforcement and helping companies track and understand their own financial flows.

While crypto prices have plummeted and bankruptcies have emerged for some players, Michael argues that crypto is hardly going away.

The lessons he offers are about patience, the start-and-stop trajectory of new technologies, and how to move forward despite difficult marketplace circumstances. He also talks about how Russia and North Korea try to exploit crypto, the advantages that crypto can offer over
traditional finance, and what it takes to navigate an environment that changes at the speed of bits.

[THEME MUSIC]

SAFIAN: I'm Bob Safian, and I'm here with Michael Gronager, the CEO of crypto data platform Chainalysis. Michael, thanks for joining us.

GRONAGER: Thanks for inviting me for this.

SAFIAN: So there's been talk lately of what's been called a crypto winter. Cryptocurrency values have been dropping and some crypto outfits declaring bankruptcy; Bitcoin down a ton. Other investments have been hit too, but it feels pretty extreme in the crypto world. Can you explain what's going on and why this is happening?

GRONAGER: It's important to remember the backdrop. We have record high inflation. Tech stocks that went up and up last year suddenly took a big, big correction. Now, crypto has matured. Bitcoin, Ethereum, the other assets have matured to become, I would say, yet another thing you invest in. So when everyone moves into cash and basically wants to divest, or divest from risk, then they also sell their crypto. That means that the price goes down, and then you see all the leverage that was built into the system. That's where it gets really ugly.

We'll probably see some of that falling apart in traditional finance as well, it's just going to happen slower than it does on the blockchain. We saw, most notably probably, the Terra LUNA that fell apart. There were a lot of investors into that platform because it generated a lot of yield, so it was very tempting to invest money into it. But suddenly, that meant that they basically went bankrupt as well. We've probably just seen them on a shorter time scale than we've seen in traditional finance, where we are counting quarters and not weeks, and in crypto, we are probably counting days and weeks instead of quarters.

SAFIAN: Because everything moves faster in crypto?

GRONAGER: Everything moves faster in crypto. That's how it is.

SAFIAN: You've been in the crypto industry for a while, and this is not the first crypto crash you've been through. Is this just to be expected, that this is the way this kind of technology and asset class works, or this stage of this technology?

GRONAGER: I got into crypto in 2011, Bitcoin what really got me interested was because I read an article about how it crashed. The first crash was when the price went up to, let's say, $30 or so. Then suddenly, the price went down to $2.
And then fast forward, we went to another hype cycle at the end of 2013 where the price goes up to $1,000. And then the same changes again, go bankrupt, and the price goes down to a couple of hundred dollars.

It's kind of a cycle where the way I best interpret what happens is that technology is being built. There's this dream about what this means for the world in the future. And then we start to live more and more in the dream and less and less in the reality. And we invest in the dream, not in the reality. And then at some point, we wake up. Yes, we can get to that dream, but it's going to take a long time to get there. And now, we need to go back and build.

SAFIAN: It sounds like when there's blood in the water, when things are looking bad, you don't get particularly anxious. You see that more as an opportunity, as a signal of where the next turn is going to be.

GRONAGER: I would say so. It's always a healthy reminder. In up times, everyone would be focusing on, but how can we grow even more than 200%? How can we grow more than 500%? You take everything for granted, and you forget about the risk in it, and the risk just hits you bad. It also goes very well in line with the company that I built around Chainalysis that we are focusing on the picts and the shovels of the industry. We are focusing on what we think is the most valuable asset in crypto, and that's data.

It's basically understanding what happens in the space. When we have good times, it's interesting when we have bad times, it's always interesting, and it just keeps growing with the adoption. We are growing at a stable pace. We see the growth of the industry. And when we see situations like this, I'm like, yeah, that would happen at some point. And right now, some of those who said a few months ago "Yeah, but it's too expensive," they might actually enter now. So it is an opportunity for people to enter the space and say, "Well, I can actually get in now, and I can buy crypto at a price that was not $60,000, but maybe 18, maybe 20, maybe 21," and then they believe that it will go up to 60 again.

SAFIAN: And these aren't tulip bulbs, right? You've compared this in some ways, to the dot-com bust in the late '90s. The foundation is real, we're just a little bit ahead of ourselves.

GRONAGER: The foundation is real. The innovation of crypto is very much about how you can create digital scarcity. Digital scarcity basically means now you have something digital that has a value. Before that, it didn't have a value. Any photo could be copied; anything could be moved and copied, so it didn't kind of have a real value built into it. And now, you build something digital with value. First application was Bitcoin. Other applications have been built and based on Ethereum. And the way it, more and more, looks what it's becoming is like an operating system for finance.

Everything that we saw as financial instruments can now be built as apps not as standalone devices, but as apps. And that's going to create a lot of efficiencies, flexibility.
That's going to just make everything explode in a good way. So we basically will see a lot of value generation, a lot of new business models, a lot of unlocking of illiquid assets. But at the same time, we are also far away from that dream, because a lot of things need to be built. So yeah, long term positive here.

SAFIAN: Yes. Because it's still early days.

GRONAGER: Still early days, yeah.

SAFIAN: You mentioned this, Chainalysis tracks data on blockchains. And a lot of your customers are, as I understand it, government agencies that are investigating wrongdoing, money laundering, ransomware, thefts, and things like that, as well as private firms that are trying to track and monitor their transactions and report things to regulators. Am I capturing that the right way?

GRONAGER: If we use the industry lingo here, it would be called transaction monitoring. So if you'd go to your bank and deposit $100, in the background, there's some algorithm running and saying, "Bob, he deposited $100, and that's all fine." If you came with cash for $100,000, then something might be wrong here, and then someone would look at it.

And now we need the same in crypto. But in crypto it's different because it moves faster. You don't know necessarily whether the transfer was international or whether it was local. You can't see that immediately, but we can tell you as Chainalysis. And we can tell you where it came from, we can tell you the history of those funds. So we can basically build that into a compliance program and transaction monitoring. And that enables compliance professionals to work with the regulators and ensure that that's part of safekeeping finance. Follow the money. It always worked in capturing the bad guys, and it also works in crypto.

SAFIAN: Yeah. It's interesting because the idea of crypto, I guess, is that it's more anonymous, and in that way kind of less traceable. And yet blockchains are also public, so everything should be traceable. How do you square those two ideas?

GRONAGER: Basically you create a public ledger. It's clearly something that's not meant to be anonymous in many ways. And that's been debated over the last 10 years.

The perception was, "Oh, it's anonymous money, so now I can do everything online that I shouldn't do," and people started doing that. Then suddenly, there was a reminder even back from the white paper of Satoshi that says, "Actually, it's not anonymous." It's actually trying to preserve a pretty good privacy, but it's not really anonymous.

I cannot easily find any person and individual on the blockchain, but I can understand if an individual transact, whether there was a risk associated with that transaction. That's
pretty good privacy to me. It's not anonymity. We don't need anonymity, but we need privacy to a certain extent. But we can find people that do bad things, if the things are bad enough. And that's basically striking a balance that I think is healthy for a financial system. And I think it's been working pretty well for crypto.

SAFIAN: So you can, or Chainalysis can sort of trace down maybe a specific transaction or learn more about that specific transaction, but you can't necessarily in real time monitor everything that's going on everywhere?

GRONAGER: No, because a lot of things require some manual input and some assessments here. If you, for example, see a transaction, you can see it from a darknet market, and you can see it goes into a crypto exchange. You can see something potentially money-laundering-like happened on the blockchain, but you don't know who was behind it. So how do you figure that out? You would send a subpoena, and sending a subpoena means that you have a badge. That means you send a subpoena to the crypto exchange that received that transaction and say, "Who was that?" And then the exchange would say, "Oh, that was someone," and they would send back some information about that individual.

And now they can start an investigation. They would probably figure out: is there any history around that person? Oh, it's a known drug dealer from Ohio, so we already have something that corroborates it. Doing this at scale? No, you're not doing that, but that's actually good. It just enables the way society is built, at least here in the U.S., to operate the way that we like it to operate.

SAFIAN: Now, there is some talk about sort of state-sponsored activities, maybe bad behavior around crypto. I mean, we've seen talk about a sort of a crypto nexus, talked about with Ukraine and Russia, and that maybe Russia can use cryptocurrency to evade sanctions. How realistic or practical is that?

GRONAGER: It's like, if you want to take a hundred dollars and launder them through crypto, of course you can do that. But if you want to take a hundred million dollars and launder them through crypto, first of all, there's no volume or no liquidity available in the infrastructure in crypto, so you can do it at scale. When we look at the problem, we say crypto is probably the smallest of all problems in terms of money laundering and sanction evasion. We can monitor it in crypto and assess real time.

It's at the same time an enabler to create a way that we can help funding into Ukraine, for example. That we can support people to be able to buy medicine and other things in that side of the world. So I think that the good sides, good parts of crypto by far outweighs the ability to launder a hundred dollars.

SAFIAN: Yeah. I mean, Ukrainians have relied on crypto to raise millions of dollars to help their effort there.
GRONAGER: Exactly.

SAFIAN: Is there a reason why Russia and Ukraine are sort of such centers for crypto activity?

GRONAGER: A need for some kind of foreign capital or foreign currency. And why do we need a foreign currency? That can be capital flight controls that might hinder normal businesses from operating. There might be a need for other ways to move funds in and out of the country. Or there might be a certain level of distrust in the currency of a country, and in Ukraine, there's been concern around: what would the value of the local currency be? What if there's an attack? What if there's another thing? Can we trust it? So it's good to have some other currency available. That's the same role as we've seen the dollar play in, for example, Latin America, in some countries there.

SAFIAN: I noticed that your firm recently put out an estimate about North Korea that state-sponsored hackers from there have stolen something like a billion dollars in crypto. That's a huge number, especially for that country, the size of that economy.

GRONAGER: Is it, and it's deeply concerning, right? So we are talking double digits of percentages in terms of basically what is the income of North Korea. So that's scary. And that's clearly one of the reasons why monitoring what happens in crypto, being able to investigate it following building a good regulatory framework, and if you run anything in crypto, ensure that it's safe and secure because otherwise someone will try to steal it.

SAFIAN: Yeah. And I guess there, if you can track down who's stolen it, there's not a whole lot you can do about it if it's gone to North Korea.

GRONAGER: No. So that's the challenge, right? Because again, laundering funds, they can move money into Russian exchanges. There's probably already existing networks of mules so, at the end of the day, it becomes dollars or yuan or whatever other currency, and they have a good operation around that.

SAFIAN: Yeah. So this nexus of cyber crime and crypto, it's not because of the crypto, but crypto becomes a tool that can be used.

GRONAGER: Yes. Yeah.

[AD BREAK]

SAFIAN: Before the break, we heard Michael Gronager, CEO of Chainalysis, talk about the crypto winter, as well as the risks of crypto money laundering and digital theft.

Now he talks about how and why businesses should experiment with crypto and blockchain.
He also talks about his personal journey from coder to CEO and how continuing to code every now and then feeds his leadership.

Plus, he shares lessons on looking beyond the tumult of constant change, and why down markets are a time for building.

SAFIAN: So a lot of the listeners to this podcast are business owners themselves, and some of them may be wondering, "How much should I integrate my business with crypto right now?" Right? "Should I be protecting myself? How do I protect myself and limit the risk? Should I just wait, given the thefts that go on and the uncertainty through the crypto winter?" How do you decide whether it's something that you should make a part of your business?

GRONAGER: So it's a little bit discussing the same around the internet in the '90s, right? A few companies called "internet companies," and they created this cohort of companies that you would look at and say, "They're a little bit crazy. Maybe it will crash. What will go on there?" And then slowly people started to be present on the internet. They got an email address, so they could be contacted that way. They got a website, so people could find them. And that was the first step into that.

And maybe the first step into crypto that's similar to that is enabling crypto payments if that makes sense for the business model you have. Approach your customers through NFTs or other things, and assess whether that's a part of the marketing strategy. You probably end up creating something that looked like websites back from the '90s, something people would look at for a while, and then they expect them to maybe change to something that has another level of aesthetics. So I think we are early in the phase today. But I think familiarizing ourselves and your own business model with what it could use crypto for going forward will be important, and that's where you should probably focus today.

And then I would say, at some point, every company will become a crypto company. And it will go in that direction, but it's also going to take some years before we get there.

SAFIAN: You used to work personally on crypto investigations. Mt. Gox, and Silk Road, the Welcome to Video case that Wired recently ran a book excerpt about. What lessons have you learned in making the transition from being a coder, cobbled together a tool on a trans-Atlantic flight, as I understand, to being a CEO? Right? How does that role shift as a leader?

GRONAGER: I think my career before getting into crypto in various ways have always been a mixture of getting deep in technology and then, when you get deep in technology, you create something. And then you need to move into becoming an operator and management.
So I've always been between those two areas, running big European projects and computer centers. What I focus on is trying to understand the systems that we are creating.

It's not coding, I wouldn't say, but it's definitely an organism or a system where everyone has a role and has a potential for a lot of impact or less impact. Going from being a small start-up on the couch, sitting at home and coding, and having more than 700 people in the company today, there's a lot of transitions and understanding of scale that I needed to learn.

SAFIAN: Do you miss getting your hands dirty and just being able to dig in and code something and make something?

GRONAGER: Of course I do. It's fun. I like that. And I would do stuff like that every now and then where I dive deep into something, if the time allows it. And then hand it off to the team or say that was just a little exercise that kept me sharp and made me understand something. It's also how I work. I understand the best things when I play with them a little bit and sometimes you need to code to play with them.

SAFIAN: And I guess it's good to remind the team that you know how to do some of the things that they do also. Right?

GRONAGER: I do. Yeah.

SAFIAN: The crypto world, as we mentioned, seems to be constantly moving. And certainly from Bitcoin, there are now tons of different currencies, it's like a multi chain universe. With new things emerging every day, every second, what do you focus on? How do you decide what really matters in an industry that's changing so constantly?

GRONAGER: It's not really up to us to decide it as a data company. We basically provide the data for people to assess it. The latest product that has been announced is called Storyline. Storyline is interesting because it basically abstracts a lot of things away for the user. So it'd be like if I send money to you, it's a very simple event. It's a transaction. It can be displayed in a simple way and understood. But if I do the same in a smart contract, and smart contracts are part of Ethereum and a lot of more modern blockchains, then I can invoke other smart contracts in the same transaction or event. And then suddenly there might be 10 or 40 counterparts involved in that transaction that all play a role and different tokens involved. And that's basically visualizing that in a very simple way. So that's been a lot of, I would say, COVID time, spent for me in thinking through how do we make that approach real?

SAFIAN: You've got this product roadmap and at the same time, this external environment that's fluctuating. I know for a lot of folks listening, running their own start-ups and businesses,
they're like, can be uneasy about how much do you accelerate in a moment where the 
environment is unstable, versus "oh, let's just batten down the hatches and be protective and 
ride things out." How do you think about that?

GRONAGER: It's been said a lot of times in crypto, that bear markets are times for 
building, and now it's time for building. And I do think it's time for building because as I 
started out saying, we basically invested in this dream, and then we woke up to find out 
that the dream was not real yet. So we need to invest more.

And it also means that what happens in a boom market, like last year, you have an influx 
of new customers. They need to be educated about the ecosystem. They need products; 
they need onboarding, and that takes a lot of time away from the building. So this is a 
good time to build product.

SAFIAN: And it sounds like there's an ongoing priority to continue to normalize crypto for 
businesses and for individuals. Is that what's at stake for Chainalysis right now?

GRONAGER: I would say it is, of course, like when we first built a company, we had one 
cryptocurrency; that was Bitcoin. It was definitely simple in many ways. And then there 
were a few others. But then you go from a few to many, and as soon as you go to many, 
you need to say, "Okay, how do we make the entire system scale? How do we do it all?" 
And I think we are in that phase right now.

And that's where, well, whatever happens in crypto right now, we have a lot of resilience 
because we built for not just one or two, but for thousands. And that's basically the 
mentality and how you need to think about it. It also means that the fluctuations that we 
see today and the cares in the market are basically just parts of what we can see and 
mesh and analyze in our products.

SAFIAN: Well, Michael, this has been great. You have educated me about this in a way that's 
super useful. Is there anything that we haven't talked about that we should have? Anything that I 
didn't ask you about?

GRONAGER: You didn't ask me about the price of crypto tomorrow and the next year, 
but I probably wouldn't have answered anything because it can go in any direction.

SAFIAN: But it sounds like as you, in the beginning, you went through each of the previous 
crypto winters, the bottom keeps going up from $2 to a hundred dollars to a thousand dollars. 
Right?

GRONAGER: Yes.

SAFIAN: And that certainly indicates something.
GRONAGER: It indicates something. Right now it's hard to assess where it is, but the bottom is definitely higher than it was last time, and I think that's a good reminder to say, “This is something that’s growing, and is long term, and it will change the world.”

SAFIAN: Well, Michael, again, thank you so much for doing this. I really appreciate it.

GRONAGER: Thank you so much. Take care.