What is an Automated Market Maker (AMM) and its Pros and Cons

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Decentralized finance, or DeFi, has been one of the most revolutionary applications in Web 3. So, what is automated market maker, and how does it find a place in this sphere? The advent of decentralized exchanges (DEX) has not just democratized the adoption of cryptocurrency but has also given rise to new and innovative ways to access financial opportunities – Automated Market Maker being one among the many ways that were traditionally never heard of. Yes, now you can do all the major banking activities within the crypto ecosystem minus an intermediary. In a traditional setup, the intermediary, as we all know, retains the unilateral power to choose to serve you or ignore you. However, the tables turn in the case of a decentralized setup, where none alone and all together make up the platform's ecosystem via peer-to-peer interaction.

This article will help you understand what is Automated Market Maker, i.e., AMM, a fundamental pillar in DeFi – in the most beginner-friendly manner.

Who is a Market Maker?

Imagine you're a farmer wanting to sell your farm produce. Who do you sell to? A buyer. Now imagine you're somebody who needs to buy some veggies for consumption, i.e., a consumer. Who do you buy from? Yes, that's right, a seller!

In this scenario, let's think of a conventional way of successfully completing a transaction. Getting the farm produce to actual consumers would require a great amount of planning and logistics. Packaging, transporting, storage, shipping, and collecting payments require a lot of resources. Apart from these, each of these steps can put a significant financial burden on the farmers.

So how do the farmers sell? This is where the intermediaries come in. The mediators purchase goods in bulk from farmers. They take care of all the intermediate processes, add their cut over the purchase price (hence the concept of 'markup'), and then sell it to consumers like us.