What Is a Market Maker?

The firm that quotes both sides of every market so you can trade instantly — how it earns the spread, the inventory risk it carries, and the token deals that give it a bad name in crypto.

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A market maker is a firm that stands ready to both buy and sell an asset at all times, quoting a price for each, so that anyone wanting to trade can do so instantly rather than waiting to find a matching counterparty. When you hit "buy" and your order fills in a fraction of a second, the reason is almost always that a market maker was there, offering to sell. They are the invisible counterparty behind a smooth market, and understanding them explains a great deal about why some markets are easy to trade and others are treacherous. This report covers what they do, how they earn, the risk they carry, and the specific and sometimes troubling role they play in crypto. It assumes you know what market liquidity is.

AT A GLANCE

WHAT IT IS **Firm quoting both buy and sell**	PROVIDES **Liquidity — instant tradability**	EARNS **The bid-ask spread, repeatedly**
CARRIES **Inventory risk on its holdings**	CRYPTO FORM **Firms, and AMM code**	WATCH FOR **Token deals with bad incentives**

01

The job, defined

The market maker's function is to be a permanent counterparty. On any asset it covers, it continuously posts two prices: a *bid*, at which it will buy from you, and an *ask*, at which it will sell to you. Both quotes stand at the same time, which is the whole point — whichever side you want to trade, someone is already there to take the other side.

This solves a problem that would otherwise cripple a market: the coincidence problem. Without market makers, a buyer must wait until a seller happens to want the exact same asset in the exact same quantity at the exact same moment, and vice versa. Trades would be slow, uncertain, and priced erratically. The market maker removes the wait by always being willing to transact, absorbing the timing mismatch between buyers and sellers into its own book. It is, in effect, a shock absorber for the flow of orders — and the reason the market feels continuous rather than lurching from one chance meeting to the next.

02

How it earns: the spread

A market maker is a business, and its core revenue is the bid-ask spread — the gap between the price at which it buys and the price at which it sells. It quotes a bid slightly below the going rate and an ask slightly above, and when it buys from one trader at the lower price and sells to another at the higher, it keeps the difference.

On any single trade that difference is tiny. The model works because of volume: a market maker may transact thousands or millions of times, earning a sliver on each, and those slivers compound into the business. This has a consequence worth internalising — the spread you pay as a trader is the market maker's revenue, which is why a competitive market with several market makers has tighter spreads (they undercut each other) and a market with one or none has wide ones. The spread is not an arbitrary fee. It is the price of immediacy, set by how much competition there is to provide it, and it is the same spread examined from the trader's side in our note on market liquidity.

03

The risk it carries: inventory

Earning the spread is not free money, because to always be ready to sell, a market maker must hold an inventory of the asset — and that inventory has a price that moves. This is the central risk of the business, and understanding it explains most of what market makers do.

Suppose a market maker buys from a stream of sellers during a falling market. It is accumulating an asset that is dropping in value, and the spread it earns can be swamped by the loss on the inventory piling up on its books. The danger is sharpest in a one-sided market: when everyone is selling, the market maker is the buyer of last resort, taking on more and more of a falling asset. This inventory risk is why market makers manage their holdings actively, hedge their exposure where they can, and — critically — widen their spreads or pull their quotes entirely when volatility makes the risk unbearable. Their withdrawal at the worst moment is not cowardice; it is the rational response of a business protecting itself from being run over, and it is exactly why liquidity thins precisely when it is most needed.

> *A market maker is not doing you a favour and not betting on the price. It is running a volume business on a thin margin, and the moment holding inventory becomes too dangerous, it widens its quotes or leaves — which is why the smoothest markets can seize up in seconds.*

04

Not a directional bet

A common misunderstanding is that market makers are trying to predict which way the price will go. The pure version of the business is the opposite: a market maker aims to be *neutral*, profiting from the spread and the volume of trading regardless of direction, not from the market rising or falling. Its ideal is a busy, two-sided market where buys and sells roughly balance, letting it turn over inventory quickly and bank the spread again and again without accumulating a large one-way position.

This is why market makers are described as providing a service rather than taking a view. In practice the line blurs — managing inventory forces choices that look directional, and many firms run other strategies alongside their market making — but the core activity is genuinely distinct from speculation. Confusing the two leads people to imagine a market maker as a giant trader betting against them, when it is closer to a currency exchange booth at an airport: it does not care where exchange rates are heading, only that people keep coming to both buy and sell.

05

The two meanings in crypto

Crypto uses the term for two genuinely different things, and conflating them causes real confusion. The first is the traditional kind described above: professional firms that quote on centralised exchanges, hold inventory, and earn the spread, operating much as their equity-market counterparts do.

The second is the *automated* market maker — not a firm at all, but a piece of smart-contract code that sets prices from a formula operating on a pool of assets, with no order book, no quotes, and no human deciding anything. Anyone can supply assets to the pool and passively earn a share of trading fees, effectively becoming a fragment of the market maker. This mechanism is the engine of decentralised exchanges and behaves quite differently from a quoting firm; we cover it in full in our note on automated market makers. The essential distinction to carry away is that one is a company managing inventory and the other is an algorithm managing a pool — both make markets, by completely different means.

06

Token market making, and its incentives

Here is where crypto departs sharply from tradition. When a new token launches, it usually has no natural liquidity — no established base of buyers and sellers — so projects hire market-making firms to provide it, making the token tradable from day one. In its clean form this is a legitimate and necessary service. But the arrangements are where trouble lives.

These deals are frequently structured in ways that create poor incentives. A market maker may be lent a large quantity of the project's tokens and given an *option* to buy them at a set price later, so its reward can depend on the token's price reaching certain levels — which quietly turns a neutral liquidity provider into a party with a stake in the price going up. Some contracts are opaque, and the line between providing liquidity and actively pumping a token can blur. There have been episodes of firms accused of manipulating the tokens they were hired to support, and of token prices collapsing when a market maker returned its borrowed tokens and withdrew. For anyone evaluating a token, the identity and terms of its market maker are a real and underexamined risk factor, not a technicality.

07

Why any of this matters to you

You never see the market maker, but its presence shapes every trade you make. The spread you pay is its pricing, so tighter spreads signal healthy competition among market makers and wide ones signal its absence — a quick read on whether a market is well served. The *depth* you can trade into is largely their inventory made available, so the ease of moving size is a direct reflection of how much market-making capital is committed to that asset.

And the fragility is theirs too. Because market making is voluntary and self-protective, the liquidity you rely on can vanish in a violent move, when the firms providing it step back to avoid being run over. This is not a flaw to be indignant about; it is a structural feature to plan around, especially in the thinner corners of crypto where a single firm's withdrawal can empty a market. Knowing that the counterparty behind your instant fill is a business managing its own risk — and can decline to be your counterparty exactly when you most want one — is part of trading these markets with your eyes open, alongside choosing where you trade, as in our note on picking a beginner exchange.

08

The honest summary

A market maker is neither villain nor benefactor. It is a business providing a genuine and valuable service — the immediacy that lets you trade the instant you decide to — and charging for it through the spread, while carrying real inventory risk that governs when it will and will not stand in the market. That is the clean, traditional picture, and most of the time it is the accurate one.

Crypto layers two complications on top: the same word describes both quoting firms and pool-based algorithms, and the token-launch market-making deals introduce incentive problems with no real equivalent in traditional markets. Hold all three ideas at once — the legitimate core service, the automated variant, and the questionable token arrangements — and you understand not just what a market maker is, but why the quality and honesty of a market can vary so enormously from one asset to the next.

> *“A false balance is abomination to the LORD: but a just weight is his delight.”*
>
> PROVERBS 11:1

Methodology & Sources

This report explains a market role; it contains no spreads, fee figures, firm names, or token names, all of which vary and change — observe current conditions on the venue and asset concerned. The definitions used are standard: a market maker as a participant continuously quoting two-sided prices and earning the bid-ask spread; inventory risk as the exposure created by holding an asset in order to quote it; and the neutral, non-directional character of pure market making, acknowledged to blur in practice as firms manage inventory and run additional strategies. The two crypto meanings — professional quoting firms and automated market-maker smart contracts — are genuinely distinct mechanisms and are described as such. The account of token market-making arrangements, including token loans and call options and the incentive problems they can create, describes documented general practices and structures; no specific firm, token, or event is named, and the reference to alleged manipulation and to price collapses on market-maker withdrawal characterises a recognised category of episode rather than asserting any particular case. Nothing here is a recommendation regarding any firm, venue, token, or trade.
