

# Crypto Winter Puts Focus on Business Fundamentals and Due Diligence

Cryptocurrency values have taken a battering in recent months, putting some high-profile companies out of business. The downturn has emphasised the importance of keeping traditional business principles in mind when investing in the digital assets sector.

In the aftermath of the dramatic collapse of the value of cryptocurrencies earlier this summer, the digital assets industry has entered what insiders call a crypto winter, or a long period of depressed asset prices. It has thrown the spotlight on the ability of the blockchain-based sector to overcome its growing pains and establish itself as a new form of finance.<sup>1</sup>

Since Satoshi Nakamoto outlined the idea for bitcoin in late 2008,<sup>2</sup> the digital asset sector has evolved to include thousands of different types of cryptocurrency in many different forms,<sup>3</sup> as well as other products such as non-fungible tokens (NFT).

Individuals and companies with track records as savvy financial and technology investors have gotten involved in this industry and slowly and methodically built

businesses either as investors or as service providers to, for example, sports leagues that have launched NFT revenue streams.<sup>4</sup> Many of these people and businesses such as Sam Bankman-Fried<sup>5</sup> of FTX, a crypto exchange, and Brian Armstrong, chief executive officer of Coinbase,<sup>6</sup> another crypto platform, have become household names, at least in the digital assets world.

## Rocky Paths

At the same time, others with less than stellar track records as financiers or technologists also saw the same opportunity and believed they could be successful too. Some barely out of college launched themselves as digital-asset entrepreneurs without solid business foundations or the necessary technical skills to develop products with long-term futures. But they managed to

<sup>1</sup> "Blockchain Monthly Highlights: Crypto Winter Called Historic by Experts": <https://investingnews.com/blockchain-monthly-crypto-winter-historic/> (July 11, 2022)

<sup>2</sup> "History of Cryptocurrencies," Harvard Gold and Economy Observer (last visited September 26, 2022): <https://www.harvardgeo.org/history-of-cryptocurrency/>

<sup>3</sup> Andrew Loo. "Types of Cryptocurrency," CFI Education Inc. (last updated September 16, 2022): <https://corporatefinanceinstitute.com/resources/knowledge/other/types-of-cryptocurrency/>

<sup>4</sup> NBA Top Shot (last visited September 6, 2022): <https://nbatopshot.com/>

<sup>5</sup> "Icon: The Untold Story Of Crypto Billionaire Sam Bankman-Fried": <https://www.forbes.com/sites/bdoherly/2021/05/16/icon-the-untold-story-of-crypto-billionaire-sam-bankman-fried/> (May 16, 2021)

<sup>6</sup> "The Good, Bad and Ugly": Film Looks at CEO Brian Armstrong's Creation of Coinbase": <https://www.thestreet.com/crypto/news/coinbase-ceo-brian-armstrong-film-coin-founders-story-amazon> (October 5, 2022)

create sparkling narratives to convince others to hand over their money. Few of those involved thought about diversification or risk management. If they did, they did not think about them enough.<sup>7</sup>

Entrepreneurs who came a cropper earlier this summer included those who ended up with worthless, or near-worthless, holdings after deciding to launch companies based on risky digital asset investment opportunities in a sector with a short track record.<sup>8</sup>

The belief in a “supercycle”, or prolonged bull market, for digital assets and unwarranted faith in the idea that the value of cryptocurrencies was set to rise for the foreseeable future means a long line of lenders are queuing up to get their money back from digital asset entrepreneurs whose strategies went awry. Some of the failures had a few things in common such as secretiveness about strategy, substandard reporting, and overpromising but underdelivering.<sup>9</sup>

## Right Regulation

The demise of these companies has pushed countries around the world into examining whether their regulation of cryptocurrencies and digital assets are strict enough to prevent something similar happening there. The Monetary Authority of Singapore (MAS) is one regulator that has been forceful in repeating its commitment to innovation, not speculation, in digital asset and cryptocurrency markets.

“MAS seeks to anchor in Singapore crypto players who can value add to our digital asset ecosystem and have strong risk management capabilities,” Ravi Menon, MAS’s managing director, said<sup>10</sup> at an industry event in late August.

Other Asian jurisdictions have taken their own approach to crypto regulation.<sup>11</sup> Hong Kong allows crypto exchanges to provide services to professional investors only – those

with portfolios worth at least HK\$8 million – China has banned banks and payment companies from offering crypto-related services, while India has passed rules dealing with the taxation of cryptocurrency.<sup>12</sup>

## Investment Preparation

Such troubles as have been this summer do not mean the digital assets sector is finished or in terminal decline. It is less than 15 years old, so a nascent area of business by most standards. It has gone through its ups and downs during that period and will continue to do so as the businesses and individuals involved learn and improve. New products will come out. Some will work, some will not. Just like any other industry.

The blockchain technology on which the digital assets sector is built is proving itself all the time as a practical invention that has enabled real financial technology innovation. Its role in the recording of ownership of a given asset at any moment in time and an immutable record of all transactions in that asset and as a protocol for establishing trust among diverse parties in a decentralised system, means it has applications in areas, apart from cryptocurrency mining and trading, such as supply chain management, ESG (environmental, social and governance) and trade finance.<sup>13</sup>

For example, companies can use blockchain to track and trace materials and products throughout the entire supply chain<sup>14</sup> and greater security, accuracy, and cost efficiency are among the benefits. When companies bring that focus to ESG, it means they can reduce carbon footprints and boost disclosure and sustainability tracking.

Instead, what these problems do show is that the digital assets sector is no different as a business proposition from any other. Investors and entrepreneurs need to arm themselves with the right financial and technological knowledge and information when considering an

<sup>7</sup> “Former employees say issues plagued the crypto company Celsius years ahead of bankruptcy”: <https://www.cnbc.com/2022/07/19/former-employees-say-issues-plagued-crypto-company-celsius-years-before-bankruptcy.html> (July 19, 2022)

<sup>8</sup> “The crypto-pocalypse comes for MiamiCoin”: <https://www.axios.com/2022/05/20/miamicoin-drop-value-price> (May 20, 2022)

<sup>9</sup> “‘The Music Has Stopped’: Crypto Firms Quake as Prices Fall”: <https://www.nytimes.com/2022/06/14/technology/crypto-industry-prices-fall.html>

<sup>10</sup> “Yes to Digital Asset Innovation, No to Cryptocurrency Speculation” - Opening Address by Mr Ravi Menon, Managing Director, Monetary Authority of Singapore, at Green Shoots Seminar on 29 August 2022: <https://www.mas.gov.sg/news/speeches/2022/yes-to-digital-asset-innovation-no-to-cryptocurrency-speculation>

<sup>11</sup> Alun John, “Hong Kong to restrict crypto exchanges to professional investors,” Reuters (May 21, 2021): <https://www.reuters.com/technology/hong-kong-restrict-crypto-exchanges-professional-investors-2021-05-21/>

<sup>12</sup> “Cryptocurrency Regulations in India,” CoinPedia (March 29, 2022): <https://coinpedia.org/cryptocurrency-regulation/cryptocurrency-regulations-in-india/>

<sup>13</sup> “Crypto Tokens: The Good, The Bad, and The Ugly” - Speech by Mr Ravi Menon, Managing Director, MAS, at Money20/20, 15 March 2018: <https://www.mas.gov.sg/news/speeches/2018/crypto-tokens-the-good-the-bad-and-the-ugly>

<sup>14</sup> Guy Flynn and Lin Pang, “Is Blockchain the Key to a More ESG-Compliant Supply Chain?” FTI Consulting, Inc. (January 26, 2022): <https://www.fticonsulting.com/insights/fti-journal/blockchain-esg-compliant-supply-chain>

investment in it. Just because the technology is new, that does not mean prospective investors can or should discard long-standing business principles that have stood to investors for decades in other industries. In other words, they need to do their due diligence and obtain the right corporate finance advice, so they know what they are investing in from a technological and financial point of view and do so in the most optimal way for them.

### Getting Through The Hype

Digital asset entrepreneurs still need a plan to bring in revenue and turn that revenue into profit that they can invest in the business to help it grow and increase its immunity against the different financial and other shocks

that will invariably happen to any business. They need the technical know-how to create new products or develop existing ones they have work better. And they need to be able to display this knowledge of and confidence in their market that will convince investors to back them with their money.

Cryptocurrencies and digital assets generally started off in a blaze of glory and hyperbole as their value raced ahead. Participants in the market thought the trajectory was only upward.<sup>15</sup> However, traditional business fundamentals and metrics still apply. Financial and technical know-how is critical to any investment decisions. The investors that prosper longer will those that keep these principles in mind.

<sup>15</sup> "Is Bitcoin Only Going Up Now? Experts Suggest So": <https://www.coininsider.com/is-bitcoin-only-going-up-now-experts-suggest-so/> (July 9, 2021)

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