The Future of Cryptocurrency

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What UK businesses need to know

- **The big currencies**
- **Shifting market attitudes**
- **Crypto in your business i): facilitating payments**
- **Crypto in your business ii): the balance sheet**

In 2022, some people still regard the world of cryptocurrency as a kind of Financial Wild West: a place where anonymity is the norm, scammers can flourish, and easy wins (or catastrophic losses) can happen overnight.

For others, the arrival of the first digital currency was the most significant fintech development of our generation. Blockchain, the technology that underpins cryptocurrency, is all set to strengthen transparency and financial governance rather than undermining it. And with the number of crypto transactions on the rise, there's an argument that by ignoring its presence, you are simply handing your competitors an advantage.

The right approach for most UK businesses will probably be somewhere in the middle. Read on to cut through the crypto hype, to understand the up and coming currencies and trends, and to get a better idea of whether elements of the blockchain/ digital currency landscape may become more relevant to your own business in the near future...

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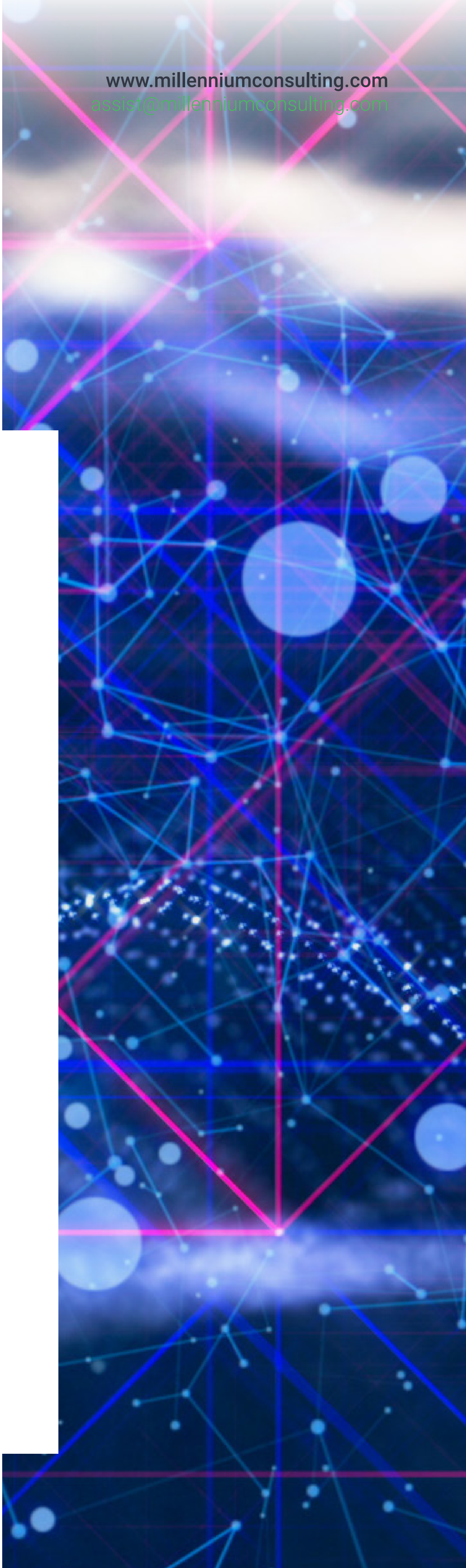
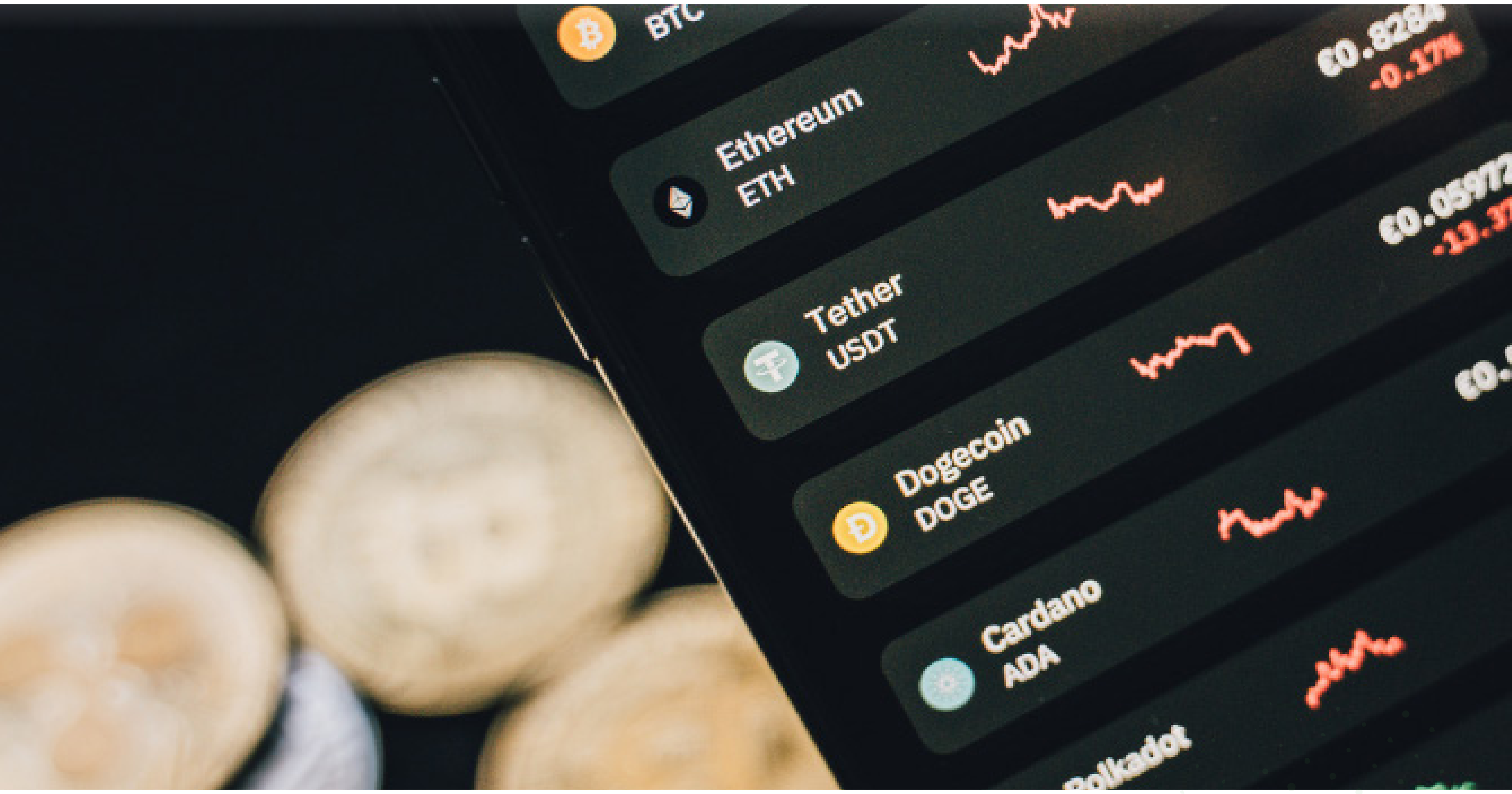


Cryptocurrency and Blockchain: A quick explainer

- Cryptocurrency (crypto) is digital money (electronic cash) that can be used to purchase goods and services. It can also be traded for traditional currency.
- The vast majority of cryptocurrencies are secured by blockchain: a public distributed ledger system by which transactions are recorded in chronological order. Each transaction a crypto coin is used for is recorded on the blockchain. Once recorded, it cannot be removed or modified.
- Blockchain relies on strong (usually 265-bit) encryption and a system of unique digital fingerprinting to ensure the blocks that comprise the chain cannot be tampered with once created.
- Traditional currencies are issued, regulated and controlled by governmental authorities (central banks). By contrast, crypto currencies rely on "crypto mining". This consists of "miners" using significant processing power to solve complex equations to verify blocks of transactions. These transactions are then updated on the decentralised blockchain ledger. In return, miners are themselves rewarded with new coins.
- As the machines deployed by miners become more advanced, the difficulty of the equations increases. The idea is that this increases the scarcity and maintains both the integrity and value of the currency.



Five big names to be aware of

Bitcoin (BTC)
Market cap 42% (Source: Statista, as at March 2022)

The original cryptocurrency, the Bitcoin concept was created in the midst of the 2008 Great Recession as people grew distrustful of banks and their role in the financial system. The currency itself was launched in 2009 and was presented as a way to transact without using a third party.

Over the last 13 years, lots of other cryptocurrencies have emerged, with most trying to improve on aspects of Bitcoin's performance (e.g. improved anonymity or quicker transactions). However, Bitcoin is still the most popular currency by some distance and is likely to remain so.

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Ethereum (ETH)

Market cap 19.06%

Ethereum went live in 2015. It is faster than Bitcoin, with an average verification time for transactions of 13 seconds, compared to around 10 minutes for Bitcoin. However, the main difference concerns the complexity of its underlying blockchain framework. The Bitcoin blockchain is a simple database of accounts (aka wallets). The Ethereum blockchain is more sophisticated, enabling the creation of applications that are of special relevance to businesses.

These applications include “smart contracts”: a way of automating contracts so they will automatically and securely execute when defined conditions have been fulfilled (useful for swiftly enabling release of funds when work has been completed). The Ethereum network also allows for the creation of private cryptocurrencies or tokens. These can be used within organisations as a way of representing shares or as an authorisation method.

So while Bitcoin looks set to remain the most popular currency overall, look out for wider adoption of Ethereum for commercial and business use cases.

Tether (USDT)

Market cap 4.1%

Tether is the most popular of the crypto category known as fiat-collateralised stablecoins. This means that the value of the coin is pegged to a traditional fiat currency like the euro, yen, or - in this case - the US dollar.
It is attractive to people who want to trade or invest in crypto but who want to avoid the volatility inherent in other types of currency. It is also generally quicker and cheaper to transfer your BTC or other type of crypto into stablecoin than it is to transfer it into most fiat currencies.

Binance Coin (BNB)

Market cap 3.51%

Binance is a cryptocurrency exchange platform where users can buy and sell various currencies, including Bitcoin, Ethereum, Litecoin and Dash. In terms of volume, it is the largest such exchange in the world. In June 2021, Binance was ordered by the FCA to stop activity in the UK over worries about weak consumer protections, amid a wider crackdown on the crypto industry's potential role in fraud and money laundering.

USD Coin (USDC)

Market cap 2.6%

Similar to USDT, USD Coin is a dollar-pegged stablecoin. It is managed by a consortium called Centre, founded by the peer-to-peer payments company Circle, with input from the Coinbase cryptocurrency exchange and the Bitcoin mining company, Bitmain. Although USDT is used more frequently for trades, USDC is often described as a safer alternative. USDC maintains transparent, fully-backed reserves that are attested regularly by Grant Thornton LLP.

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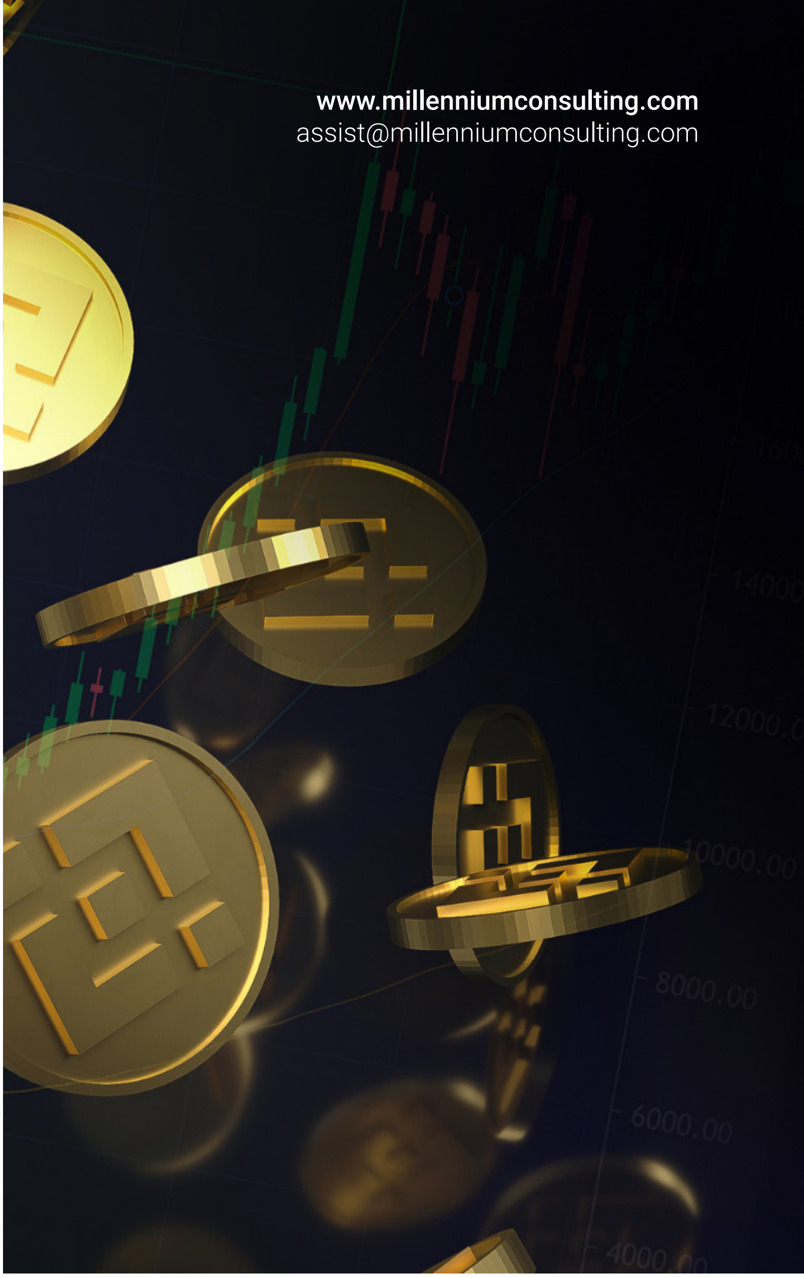

Attitudes to crypto: is it mainstream yet?

The CFO view

Gartner predicts that by 2024, around 20% of large enterprises will use digital currencies for payment, stored value or collateral.

However, the majority of finance leaders view the idea of holding cryptocurrency as a financial risk. In a survey last year, when asked specifically about Bitcoin, just 5% said they planned to hold it as a corporate asset. Overwhelmingly, volatility risk was the top reason given for not holding Bitcoin. Other reasons included broad risk aversion, slow adoption as a form of payment, regulatory concerns and lack of expertise in this area.

Consumer usage/retailer acceptance

Microsoft was an early crypto adopter. In 2014, it started accepting Bitcoin payments for games, apps and other digital content. Bitcoin can be redeemed on Microsoft accounts to be used on services such as Xbox Live, Microsoft365, OneDrive and Skype. The global cosmetics giant, Lush started allowing Bitcoin payments for website orders in 2017. The Shopify network facilities Bitcoin payments, meaning that merchants using its platform can accept the currency if they wish.

But currently, these are the exceptions rather than the rule. It's thought that around 15,000 businesses across the globe accept Bitcoin at present. Last year, an estimate from Deloitte suggested that 2,300 US businesses accept it. However, as the Financial Times pointed out, this represents just seven in every 100,000 businesses.
So this remains very much a niche payment method at present. And for the time being at least, there does not seem to be a significant growing consumer demand on businesses to offer crypto payment options. As one finance leader in the insurance sector put it to CFO Magazine recently: *"We just do whatever our consumers are asking for and make sure that we're focused on payment flexibility and payment options. And although it might be a fun item to talk about, we just don't see real consumers wanting to transact with Bitcoin at this point".*

Crypto in your business: i) accepting payment

Reasons to consider it

Appealing to a new, lucrative customer base

We've seen how in global terms, crypto usage remains relatively low. However, one recent survey showed that almost half of millennial millionaires hold at least a quarter of their wealth in it, while more than a third have at least half their wealth in it.

So the message here is to look carefully at the preferences and attitudes of your own customer base, including any new groups you would like to target. Crypto payment acceptance could be just what it takes to strengthen your appeal to a tech-savvy, high net worth customer base.

Early adopter competitive advantage

Forrester research in 2020 suggested that up to 40% of customers who pay with crypto are new customers of the company. They also spend around twice the amount of credit card users. At least in the short term, the option of crypto usage may provide your business with a valuable differentiator: one that's capable of driving new revenue in itself.

Costs benefits

Cryptocurrency transactions can generally be processed immediately, providing you with rapid access to funds and helping to streamline cash flow. As a rule, the fees associated with each transaction tend to be significantly lower than the likes of PayPal or credit card providers.

Making it happen

The easiest approach to crypto takes the form of a simple payment facilitation strategy; in other words, making it an option for customers to use cryptocurrency to receive or make payments. Companies adopting this approach will typically use a third-party vendor. Acting as your agent, it's this vendor who accepts or makes payments in crypto, converting the money into and out of fiat currency along the way.

If your crypto goals are relatively straightforward (e.g. attracting a new clientele and competitive differentiation), this simple payment facilitation approach can be just what's needed to meet them. Meanwhile, the third-party vendor will handle the payments, and because you are not actually receiving any cryptocurrency directly, it keeps crypto-related entries off the books.

Crypto in your business: ii) the balance sheet

How should your company store cash which is not being immediately used, but where there remains a need to preserve liquidity?

Zachary Kirkhorn, CFO of Tesla, recently described how the company used Bitcoin precisely for this purpose. Tesla wanted to strike a balance between somehow achieving a yield on a cash investment in the medium term, while still making sure that the cash could be accessed very quickly as and when needed. Bitcoin proved to be *"A good place to place some of our cash that's not immediately being used for daily operations or maybe not needed till the end of the year and be able to get some return on that".*

While this approach might not be appropriate for every business, it illustrates how crypto could form an element of an organisation's investment strategy, especially in the future as a short/medium term asset and for leveraging against risk in other areas.

In deciding whether to introduce crypto as an asset into your business, bear in mind the following:

- What level of risk is your business comfortable with? How would holding a particular crypto asset fit into your brand of risk tolerance?
- What percentage of cash in hand should your company hold in cryptocurrency?
- Are you fully familiar with the relevant accounting, disclosure and tax provisions? Accounting rules vary across jurisdictions. Especially when assets such as Bitcoin are used to transfer funds across borders, multiple sets of rules may apply.
- Once you have made the decision to take a more hands on approach to use of cryptocurrency in the business, are there any opportunities to make strategic use of it? (Examples may include advancing efficiencies in vendor payment, customer relations and cross-border transactions).

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One to watch?

We currently seem to be at a point where a small trickle of companies are facilitating cryptocurrency payments. If (as appears possible) demand increases from customers, we would expect this trend to pick up speed. For all businesses, it's definitely worth keeping a close eye on customer sentiment to determine whether crypto payments might offer you a commercial advantage.

Arguably however, the element of crypto that's worth getting excited about at present isn't the currency, but the blockchain technology that underpins it.

Blockchain facilitates a 'smart contract' approach, whereby agreements are verified, automated - even negotiated - via a computerised protocol. Ultimately, all of this could result in fewer late payments, less time wasted on remediations and disputes, along with a lower cash flow risk. You might even be able to leverage all of this to secure things like early payment discounts on supplies and lower bottom-line contractor rates in exchange for shorter payment cycles. In other words, quicker, more secure transactions can help create valuable extra negotiation leeway.

Want to discuss new ways to bring an efficiency boost to transactions and customer contract management? Speak to Millennium Consulting today.