Web 3.0: A Seat at the Investors' Table

Web 3.0 describes the wealth of new technologies that are set to transform work, entertainment and leisure for millions of people around the world. These new technologies include blockchain, cryptocurrencies, NFTs and the metaverse. Many exist now in their own right, but Web 3.0 is the catch-all term that will bring them all together and herald a new era of prosperity.[1]

Hong Kong's new Web 3.0 Association will bring together businesses and individuals that are and will be key players in this next version of the Internet, such as FinTech providers, software and hardware developers, policymakers and advisers, to plot a way forward for the sector in Hong Kong and, in particular, build on its potential as a FinTech hub.[2]

In this Q&A, Alex Wong, FTI Capital Advisors' Head of M&A Advisory, discusses what the development of digital assets could do for the wider economy and why investors should be interested, while signposting the questions they should ask before making an investment.

How would you sum up Web 3.0 in three words?

Decentralised, blockchain, immersive.

As the next stage of the internet revolution, Web 3.0 is creating new forms of content and property rights ownership – centralised platforms no longer dictate content distribution and communication. Blockchain technology is the engine that is empowering such change, allowing decentralised record-keeping on blockchain, rather than by a centralised organisation owning it. The renewed protocol and ownership promote creativity and experimentation among the Web 3.0 community, which everyone can be a part of and contribute to in developing new applications and products that create immersive experiences that enable better user engagement and interactions without geographical restrictions.

How is Web 3.0 transforming businesses?

Its groundbreaking improvements in transparency and security are helping Web 3.0 change how businesses operate:

- Transparency: Blockchain enables users to view and verify transactions in real-time without the need for intermediaries, making Web 3.0 more transparent and secure by reducing counterparty risk in traditional centralised systems in DeFi (decentralised finance).
- Security: Blockchain and cryptography technology makes it very difficult for anyone to hack or alter data, strengthening the protection of sensitive business data.

- Decentralisation: Web 3.0 takes control of data away from centralised platforms and returns it to individuals, giving them the ability to move their data around at will without them being tied to a small number of platforms. Technology allowing internet-connected devices, rather than servers, to host websites or applications (dApps – decentralised apps) enables this.

Web 3.0 also transforms brand marketing. Gen Z is the most receptive generation to Web 3.0.[3] Social media is an integral part of this generation's daily life – Web 3.0 engages them through the delivery of immersive experiences and allows them to participate in the creative process. Often, brands and corporates redirect a significant amount of marketing expense to this new digital marketing channel for brand promotion and to target new products at these users.

Why invest in Web 3.0?

Web 3.0, in whichever form it takes, will transform business activity and consumption patterns, and promote digital assets as a new asset class. While Web 3.0 is yet to make a significant contribution to our world, corporations and investors do not want to miss out on the potential commercial value it will bring in the medium and long term.

Web 3.0 has the potential to revolutionise online direct expenditure and become a valuable digital marketing channel for brands. As a result, corporations and financial investors are seeking Web 3.0 projects that align with their strategies and benefit from synergies with their businesses or portfolio companies.

How will Web 3.0 drive digital assets investment across the region?

With DeFi, investors can access financial services without intermediaries, making it easier to buy, sell, and trade digital assets, participate in yield farming, and earn higher returns. NFTs (non-fungible tokens) are unique digital assets that can represent anything from art to real estate, and Web 3.0 allows businesses and individuals to create, own and trade them in a decentralised manner, which could open up new investment opportunities for investors in the region.

Investors are increasingly interested in acquiring rights and assets in the Web 3.0 space – what should they be aware of?

Investors interested in entering the Web 3.0 space should first make sure they have a strong understanding of the technology, regulatory environment and cybersecurity.

- Understanding the technology: Investors should have a deep understanding of the complex and challenging technology that underpins Web 3.0, such as blockchain, decentralised applications, smart contracts, and more. Without this, investors may find it challenging to evaluate the potential of Web 3.0 projects accurately.
- Regulatory environment: The legal and regulatory risks associated with these technologies are part of a constantly evolving regulatory environment for Web 3.0. For example, different jurisdictions may restrict the use of cryptocurrencies or decentralised applications.
- Cybersecurity: With the rise of Web 3.0 technologies, there is an increasing need for strong cybersecurity measures. Investors should be aware of the potential risks and evaluate the security measures in place for any investment opportunities.

What mandates is FTI Capital Advisors currently working on in this space?

FTI Capital Advisors is working on a number of prominent Web 3.0 related private capital raising projects, including:

- Index Game (Series A, financial advisor) – The first Hong Kong metaverse content creation studio officially appointed and invested by the SandBox
- Beam+ Lab (Series A, financial advisor) – A Web2.5 SocialFi company backed by a leading Hong Kong entertainment conglomerate that incubates and co-owns virtual idols, commercializes IP with the community via self-built application protocol
- HKbitEx (Series B, financial advisor) – The first cross-jurisdictional one-stop digital assets infrastructure enabler, backed by global investors across strategic partnerships

Unlike traditional businesses with boards of directors and clear governance structures, Web 3.0 projects are often decentralised. What challenges does this present?

Decentralised Autonomous Organisation (DAO) became popular in the virtual world as a way of automating decision-making and facilitating cryptocurrency transactions. They have variously been defined as structures in which token holders participate in the management and decision-making of an entity or as virtual entities that have a certain set of members or shareholders that have the right to spend the entity's funds and modify its code.

Three features of DAOs:

- They allow a broader base of people to participate in an entity's affairs;

- Decisions are implemented autonomously, i.e., they are enforced via self-executing smart contracts recorded on the blockchain; and
- As opposed to human intervention, a DAO's decisions cannot be altered or censored.

This may seem like a brave new world, away from traditional governance structures such as boards of directors, but the DAO way of doing business does present some challenges because it is experimental.

Challenges include the difficulty of verifying the authenticity of token holders that may be seeking a role in a DAO's decision-making; how to encourage enough legitimate token holders to take part in the decision-making so the DAO does not fall victim to apathy; and the concentration of power in the hands of a few that can afford to amass tokens, in which case the idea of one token, one vote, which applies in most DAOs, can fall away.

Web 3.0 is an exciting series of new technological developments that offer investment opportunities that tie into the desire by individuals to recover the control over data and privacy that has been given up in recent years to a few dominant centralised platforms.

However, understanding the investment opportunities requires diligence and persistence as well as collaboration with knowledgeable and experienced professionals in the field.

What difference will the launch of a new virtual asset service provider (VASP) licensing regime in Hong Kong on 1 June this year make to the digital asset environment in the city?

Yes, that is correct, The Securities and Futures Commission of Hong Kong (SFC) will start issuing licences from that date, requiring licensees to satisfy a fit and proper test, comply with anti-money laundering and counter-terrorist financing requirements including customer due diligence and record-keeping requirements, as well as other regulatory requirements on investor protection, for example, safe custody of client assets, financial soundness and avoiding conflicts of interest.

In addition, licensed VA exchanges and their wholly owned subsidiaries will have to submit audited accounts and financial information to the SFC regularly.

Investors should welcome this robust but smart and transparent oversight of activities and performance in this market. It should give them confidence that when they are assessing VA opportunities, they are dealing with experienced and competent professionals and entities

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Endnotes

[1] Joshua Steinberger, Forbes, 8 Feb 2023: https://www.forbes.com/sites/forbesbusinesscouncil/2023/02/08/web-30-and-the-metaverse-in-2023/?sh=1aedaa343515

[2] Zhang Tianyuan, China Daily, 12 Apr 2023: https://www.chinadailyhk.com/article/324977#HK-launches-Web-3.0-institute-to-boost-fintech-hub-efforts

[3] Ana Kreacic, John Romeo, Simon Luong, Lucia Uribe, Amy Lasater-Wille, Elizabeth Costa, Kamal Ahmed and Jonathan Paterson, "A-Gen-Z Report: What Business Needs To Know About The Generation Changing Everything," Oliver Wyman Forum and The News Movement (2023): https://www.oliverwymanforum.com/content/dam/oliver-wyman/ow-forum/template-scripts/a-gen-z/pdf/A-Gen-Z-Report.pdf