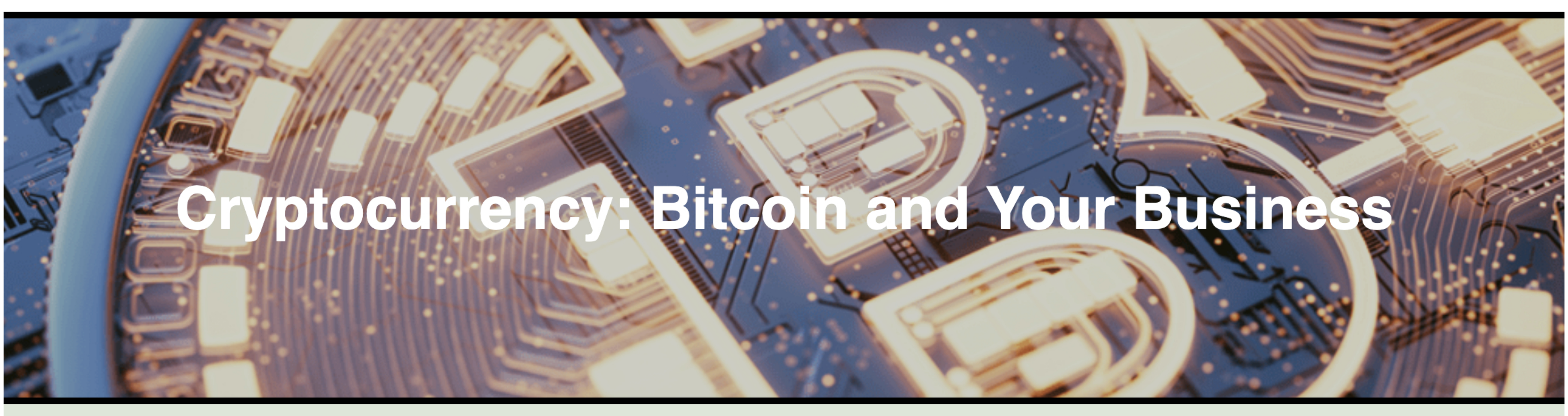

Cryptocurrency: Bitcoin and Your Business

Does the world's first cryptocurrency have a place on your balance sheet?

by *Gordon Bass and Britta Waller Melton*

For most of 2020, the price of bitcoins hovered quietly around $10,000 each. Bitcoin, which was introduced in 2013, seemed finally free of the wild price fluctuations of previous years. There was speculation that it might truly be maturing as a stable store of wealth. Institutional investors warmed to it. *Fortune* 100 companies began buying it. And individual investors around the world returned to their heady Lambo dreams of 2017.

Then the nascent cryptocurrency market proved yet again that it's anything but predictable. Bitcoin shot up to nearly $65,000 in April before plunging to $30,000 in May, vaporizing nearly $700 billion in market capitalization in a matter of weeks.

The lesson? The world of Bitcoin and cryptocurrency remains the Wild West, complete with get-rich schemes, shattered dreams and rogue players whose actions drive outsize effects.

Perhaps that's why many business leaders have steered clear of cryptocurrency and have a limited understanding of the basics of Bitcoin, its underlying technology and its promise of disruption. So let's put aside the hype and instead take a more sober look at what Bitcoin is and what it offers—and whether it has a place in your business plans or on your balance sheet.

(There are now thousands of cryptocurrencies, each with its own value proposition. While this article focuses on Bitcoin, much of what follows applies to other widely held cryptocurrencies.)

WHAT IS BITCOIN?

Bitcoin is the world's first cryptocurrency. In the words of the white paper that introduced its underlying concept in 2008, it is "a purely peer-to-peer version of electronic cash [that allows] online payments to be sent directly from one party to another without going through a financial institution."

So what *is* a bitcoin? First, despite any images you may have seen, there is no such thing as a physical bitcoin. Each bitcoin is a purely digital entity, a unit of digital code that is exchanged on its own network.

Unlike other systems of currency, such as dollars, yen or euros, Bitcoin is decentralized. It operates outside the purview of governments and financial institutions. No person or institution owns Bitcoin and the network on which it operates. This is both a strength and a weakness, but to advocates, its independence is what makes it so appealing.

If there's no banking oversight of Bitcoin, who keeps track of it? The answer is what's called a distributed ledger. Every transaction involving bitcoins is tracked on the blockchain, which is similar to a bank's ledger. Simply put, the blockchain is a database of every transaction ever made using bitcoins, and it's distributed across the entire network. That means no single entity is in control of it, and it's virtually impossible to hack or alter.

As with other currencies, the value of bitcoins is based partly on scarcity.

By design, there will only ever be 21 million bitcoins, which prevents inflation. (Today about 18.5 million are in circulation; the remainder will made available between now and the year 2140.)

Bitcoin is not backed by any commodity, nor does it have the backing of any government. So what gives it value? Billionaire entrepreneur, investor and Bitcoin skeptic Mark Cuban said in a *WIRED* video that "Bitcoin is worth what somebody will pay for it." Advocates of Bitcoin place their faith in its underlying technology and have confidence in its continued adoption. In essence, they are placing trust not in a government but in an idea.

THE RISKS

The biggest risk looming over Bitcoin is that at any point it could collectively be deemed a speculative bubble, and its value could plummet to zero.

Bitcoin savings aren't covered by FDIC deposit insurance. There's no way to trace lost bitcoins. Bitcoins that are lost or stolen—even from a major exchange such as Coinbase or Kraken—are simply gone. Criminals are drawn to Bitcoin's anonymity; in May, hackers demanded 75 bitcoins in ransom (then worth about $4.4 million) from Colonial Pipeline after accessing its computer systems. The CEO agreed to pay, knowing there was little likelihood of identifying the hackers.

> "We're in an intermediate stage. It's like the pirates are gone from the Caribbean, but it's not fully settled yet." – Joshua Sroge, CFO, Binance.US

Bitcoins are also used to purchase illegal products and services, to conceal earnings from taxation, and generally to circumvent regulation. India recently proposed a ban on trading and holding cryptocurrency, including bitcoins, with some top officials calling cryptocurrency a "Ponzi scheme." China has already banned financial institutions from providing services related to cryptocurrency transactions. Other governments have considered similar measures.

Bitcoin is also criticized for its energy consumption. "Mining" bitcoins—the computing process by which new bitcoins are created—is massively energy intensive. Every year bitcoin production consumes about 133 terawatt hours of electricity, or about half the amount the U.K. consumes. This "dirty" aspect caused Elon Musk to announce in May that Tesla would stop accepting bitcoins as payment, reversing an announcement he'd made in February.

Bitcoin benefits dramatically from its first-mover status, which is reflected in the price of bitcoins. But remember Palm, Netscape and TiVo?

Bitcoin is inherently risky.

SHOULD YOU ACCEPT BITCOIN?

Camping World Holdings announced in April 2020 that it would accept cryptocurrency as payment for recreational vehicles. "Accepting cryptocurrency is simply another part of our vision to make RV-ing easy in an increasingly digital world," Marcus Lemonis, the company's CEO and chairman, told *Businesswire* in April.

But the list of companies that conduct transactions in bitcoins is short. Microsoft began accepting them in 2014, changed its mind a few years later and then began accepting them again in 2018. Online retailer Overstock.com accepts bitcoins, but with restrictions. A few companies that sell luxury goods such as yachts, supercars and fine jewelry accept payment in bitcoins and other cryptocurrencies to attract individuals who've built wealth by investing in and trading cryptocurrencies.

Some nonprofits, donor-advised funds and foundations also accept bitcoins and other cryptocurrencies as gifts.

Most companies that accept bitcoins shield themselves from volatility by using a payment service such as BitPay, which accepts bitcoins and converts them to dollars or euros on companies' behalf.

Overall, accepting bitcoins today is mostly about publicity and perception rather than a sound financial strategy.

SHOULD YOU ADD BITCOIN TO YOUR BALANCE SHEET?

Tesla made a $1.5 billion investment in Bitcoin in early 2021 before Mr. Musk turned sour on the cryptocurrency a few months later. As of March 1, business-intelligence software company MicroStrategy had bought 90,859 bitcoins. And last year, payment processor Square signaled its faith in Bitcoin when it bought 4,709 bitcoins.

Otherwise, few companies are actively adding bitcoins to their asset portfolios.

"A corporate treasurer is not hired because they're adventurous. Until Apple, Google, Facebook, Microsoft or a company of that caliber puts a hundred million in, you won't see a lot of adoption," says Joshua Sroge, CFO of Binance.US, which licenses certain technologies from Binance, the world's largest (by volume) cryptocurrency exchange.

In any case, public companies will have an investment policy that outlines whether cryptocurrency can be on the balance sheet because of its volatility and risk profile. "One of the hurdles is getting the investment policy shifted," Mr. Sroge notes. "A small privately held company? There's a lot more flexibility."

Should your company buy bitcoins? Probably not, or, at least, not at present.

WHAT'S NEXT?

The shortest, most accurate answer? No one knows.

Warren Buffett, perhaps the most notable Bitcoin pessimist, continues to dismiss the cryptocurrency as nothing more than a "gambling device."

Mr. Sroge takes a wait-and-see attitude. "We're in an intermediate stage. It's like the pirates are gone from the Caribbean, but it's not fully settled yet," he says.

Perhaps the most relevant insight into the future of Bitcoin echoes screenwriter William Goldman's famous observation about the equally unpredictable world of Hollywood: "Nobody knows anything. Not one person … knows for a certainty what's going to work. Every time out it's a guess and, if you're lucky, an educated one."

The question for leaders considering any adoption of Bitcoin, then, is whether or not to risk financial stability on an educated guess about an electrifying new technology that nevertheless has an utterly unpredictable future.

THE AGREEMENT REALITY OF BITCOIN

What we consider *real* falls into two broad categories: experiential reality and agreement reality. Experiential reality is knowledge that you accept as true through your own direct experience or based on physical evidence. When you touch a stove and find that it's hot, that's experiential reality. Agreement reality, on the other hand, is knowledge that you accept as true because it comes from an authority figure or because it's commonly held by others to be true. And often the beliefs of the collective are, in fact, not real, despite everyone's acting as if they were. The perception of reality is amplified by social discourse.

The dot-com bubble of the late 20th century expanded in part because the value of tech and internet companies was seen through the lens of agreement reality. Investors shared a collective belief, fanned by the popular press, that these new companies were primed for nearly unlimited potential growth. This shared belief, in turn, meant that investors could ignore traditional fundamentals such as price-earnings ratios to determine value.

They were soon proven wrong: By 2000, this collective delusion gave way to the sting of experiential reality as the value of internet stocks plummeted by about 75%.

Currency, particularly the fiat money that has predominated in the 20th century with the retirement of the gold standard, has no intrinsic value. It has only the value that parties agree upon.

What does this presage for Bitcoin? In the mid-2010s, thought leadership articles about Bitcoin frequently included the cautionary term "collective delusion" and warned against participating in a nascent bubble that could burst at any moment. The value of bitcoins, critics said, was based solely on social perception—although one could argue that most other fiat currency is no different, even though it has the backing of its issuing government.

Interestingly, the consensus seems to be slowly shifting. Today, skeptics are still legion amid a cacophony of social dialogue. But Bitcoin is gaining grudging acceptance from banks, e-payment platforms and even publicly traded companies, especially as it is increasingly considered more a store of value than a digital currency.

RELATED CONTENT

Sharing the Wealth: Accessible Cryptocurrency Trading

The Post-Pandemic Consumer

Mistruths and Consequences