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# spirit

## SOUTHWEST AIRLINES + AIRTRAN

Van Phillips asked  
three questions  
that changed the world.  
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# Golden Idea

## Bitcoin's getting a lot of buzz. But how does it really work?

BY JILL COODY SMITS

**B**Y NOW YOU'VE probably heard of Bitcoin. But what is it: an innovative, universal form of money that will alter the way we live, or an unstable, unchecked hoax? How on Earth does it work, and why should you care? While not simple, the answers (at least to some of those questions) do exist.

In the simplest terms, Bitcoin is a global, Internet-based currency that is available to everyone. Bitcoin with a capital "B" refers to an overarching payment system, while bitcoin with a lowercase "b" refers to a monetary unit. It is the most prominent of many cryptocurrencies—digital

CONTINUED ON PAGE 62

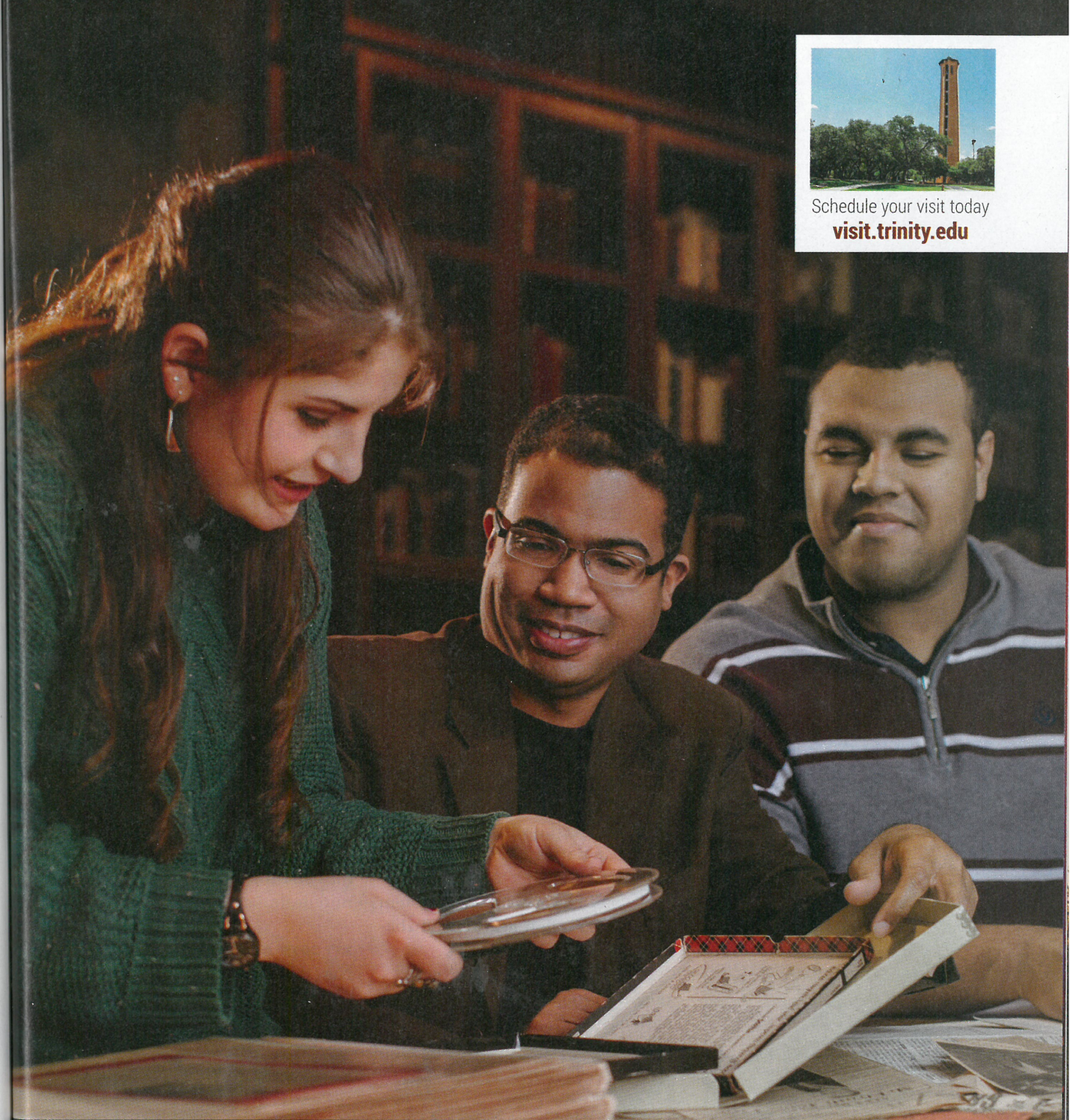
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### (Business)

systems of money that use encryption to secure transactions.

It's also important to note that Bitcoin is in its infancy, and while it may not be ready for prime time, many believe it will eventually change the way we all pay for goods and services.

#### THE VIRTUAL BUCK STARTS HERE

In 2009, someone (or a group of people) working under the name Satoshi Nakamoto released a software system that allowed individuals to securely and directly pay one another with a digital currency. It's worth reiterating the "securely and directly" part because in computer science, there had been a long-standing problem called "double spending" that made it impossible to know whether someone duplicated and double spent electronic cash unless a third party (e.g., a bank) verified it.

Bitcoin solved that problem by using an "open source distributed system," which means you can, in theory, recoup bitcoins loaned to a co-worker during lunch without waiting for the bank to confirm she's good for it. That's because the system simply won't allow her to spend a bitcoin she doesn't have.

As bitcoins are spent, transactions are grouped into blocks and entered into a sort of giant, virtual bank ledger called the "blockchain." Those blockchain transactions are verified by a huge network of people called "miners."

In order for a miner to verify a block of transactions, he or she must first gain access to it. Each block is locked behind an extremely complex password, and miners use high-powered computers to run the complex calculations that lead to correct passwords.

When a block is unlocked, a new bitcoin is released into circulation. So miners act as both bookkeepers and currency producers, and they're

**The complex passwords miners are required to break in order to hatch new bitcoins are designed to be increasingly complicated.**

compensated in bitcoins (about 25 for every block they unlock).

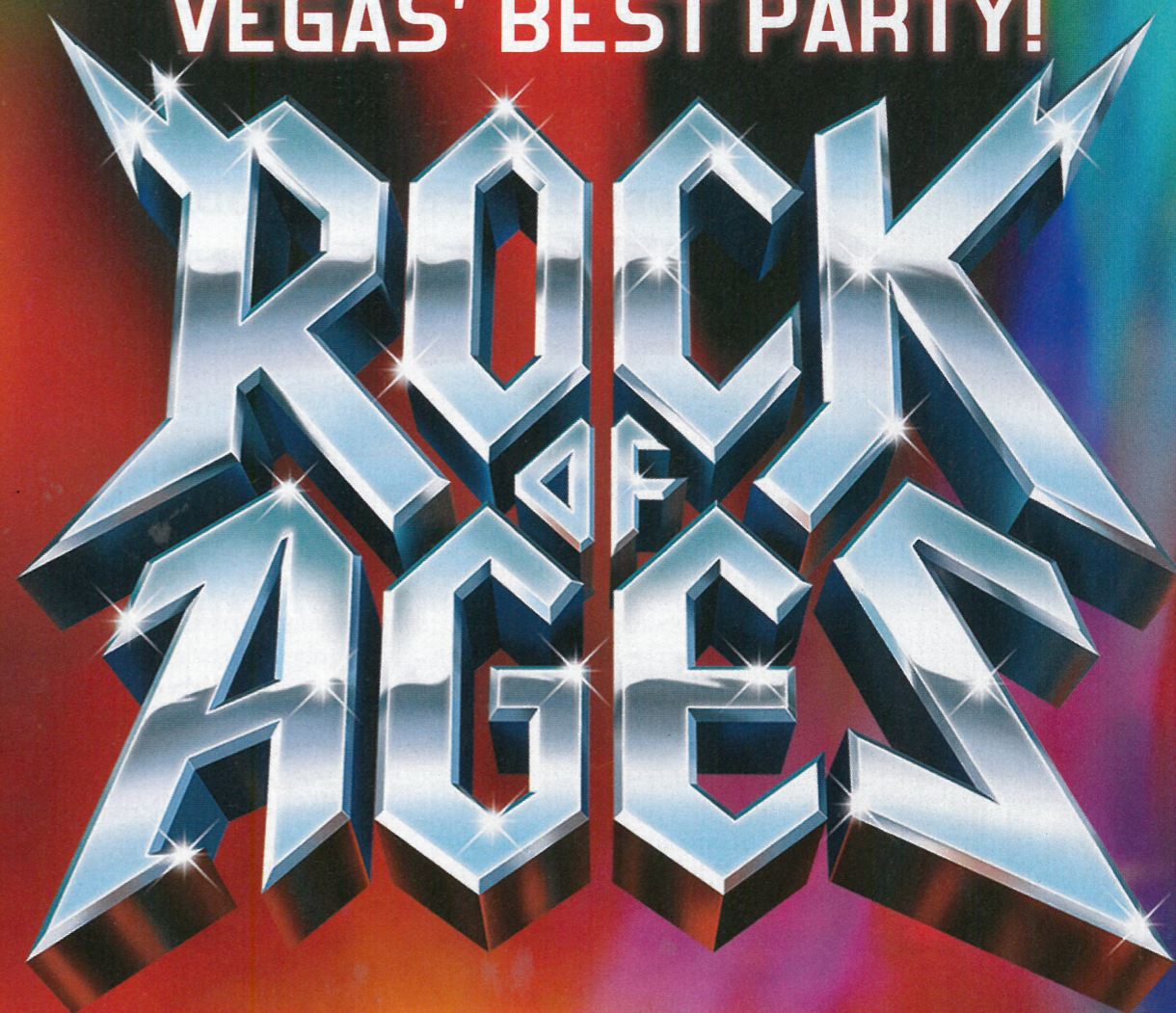
There is a finite supply of bitcoins—21 million—and the complex passwords miners are required to break in order to hatch new ones are designed to be increasingly complicated. Nakamoto created it that way, so that the supply increases gradually. (Nakamoto also designed the system to produce a maximum of 25 bitcoins every 10 minutes, another control measure.)

#### BITCOIN AND YOU

Now that you (kind of) understand the Bitcoin system, perhaps you want to use it. First, you have to buy bitcoins, much like you'd need to buy pesos if you went to Mexico. In this case, rather than hitting the airport exchange booth, you'll need to purchase a bitcoin wallet—computer software that allows you to store, spend, and receive bitcoins on your mobile device or computer—from a site like Blockchain.info. Then you'll need to fill it with bitcoins purchased from a site like Coinbase.com. Or, if you're in Austin, Texas, where America's first bitcoin ATM is located, you could exchange your cash for bitcoins much like you would withdraw funds with your debit card.

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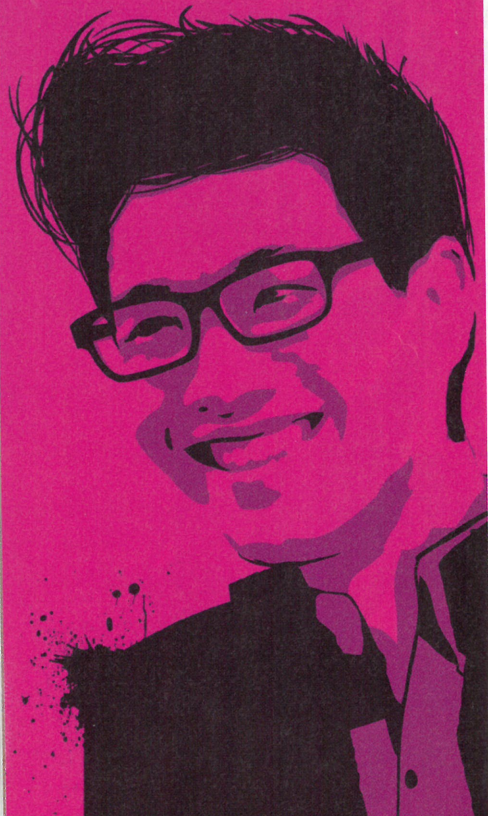
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## (Business)

### The instability, coupled with its unheard-of price spike, has convinced Williams that Bitcoin is in a soon-to-burst bubble.

However you acquire your bitcoins, once you're flush, you may want to spend them. Via an encrypted code, you can transfer funds from your wallet to someone else's. It's akin to sending someone an email, only the message is in bitcoins.

Keep in mind, though, that only a small number of merchants currently accept bitcoins. Even in Austin, if someone stocked their wallet at that ATM, they'd be hard-pressed to spend it locally. (They could, however, shop on Overstock.com, which began accepting bitcoins in January.)

#### A BITCOINER'S POINT OF VIEW

Paul Snow is president of the Austin-based Texas Bitcoin Association. In 2011, he impulsively bought some bitcoins for around 77 cents each and all but forgot about them until 2013, when he watched the price skyrocket from \$34 to \$1,200 over the course of the year. In November, the 54-year-old quit his job as a software developer to focus his attention on Bitcoin.

Snow says he was drawn to Bitcoin in part because "economically, we want a system that keeps score fairly, transparently, and in strict accordance with rules that are applied equally to all involved."

While acknowledging some shortcomings, like an insufficient infrastructure, he expects that Bitcoin will have the corner on the virtual currency market—at least in the short term. "Bitcoin is going to be a hugely disruptive technology, and there are people who will make a phenomenal amount of money from being in on it early on."

#### SECURITY, CONTROVERSIES, AND REGULATION, OH MY!

While there are plenty of winning Bitcoin stories like Snow's, many experts believe it should be approached with caution.

Mark Williams, a risk management expert and finance lecturer at Boston University, says questions about Bitcoin's security, as well as its tarnished reputation, volatility, and troubled infrastructure, are all reasons to be skeptical of it. Pointing to the drawn-out collapse of Mt. Gox (in late February, the company, once the largest bitcoin exchange, shut down, resulting in the loss of a speculated \$400 million worth of bitcoins), Williams says Bitcoin "rests on a false belief that self-regulation, untraceable currency, and transactions outside of well-tested and established banking channels can be done safely with little risk to customers."

Jerry Brito, a researcher at the Mercatus Center at George Mason University, agrees that Bitcoin might be a risky investment, but says the high-profile incidents are simply growing pains of a young industry. "A lot of these first-generation companies started by hobbyists are failing and being replaced by very serious companies backed by prominent venture capitalists."

Despite interest from investors, some experts view Bitcoin as a scam or pyramid scheme, in part because only a handful of people own half of all bitcoins in circulation. In response, Brito says, "Whatever you think of their motives, whether it was for profit or ideological, they solved the double spending problem. They deserve to profit, as they've accomplished a technological feat."

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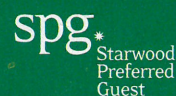


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Finally, there's the fact that Bitcoin is a decentralized currency with no connection to a government. Williams has fundamental issues with this point, and in his testimony at the New York State Department of Financial Services' hearings on the regulation of virtual currencies held in January, he emphasized how the dollar took centuries to earn respect and still relies on a sound central bank, regulation, and enforcement, while Bitcoin has none of that. "Economies are driven not by math models and equations, but by people," he says. "Bitcoin still has a long way to go before it should be relied upon as a mainstream means of transaction or even for investment speculation."

It does appear that regulation is inevitable, and there are moves to clarify how both state and federal rules apply to virtual currency. In that vein, Benjamin Lawsky, the superintendent of New York's Department of Financial Services, recently announced plans to "adopt enhanced consumer disclosure rules, capital requirements, and a framework for permissible investments with consumer money."

### DON'T BLINK

As Williams says, "In Bitcoin world, a week is equivalent to a decade in real life." To illustrate that point, consider what occurred over several weeks in early 2014. There was the perplexing disappearance of Mt. Gox; Charlie Shrem, founder and CEO of early Bitcoin player BitInstant, was arrested for laundering money for users of an Internet black market called Silk Road; Russia followed in China's footsteps by declaring Bitcoin illegal; and the price of 1 bitcoin dropped from around \$1,000 to about \$550.

The instability, coupled with its unheard-of price spike (the price of 1 bitcoin this time last year was roughly \$34), has convinced Williams that Bitcoin is in a soon-to-burst bubble.

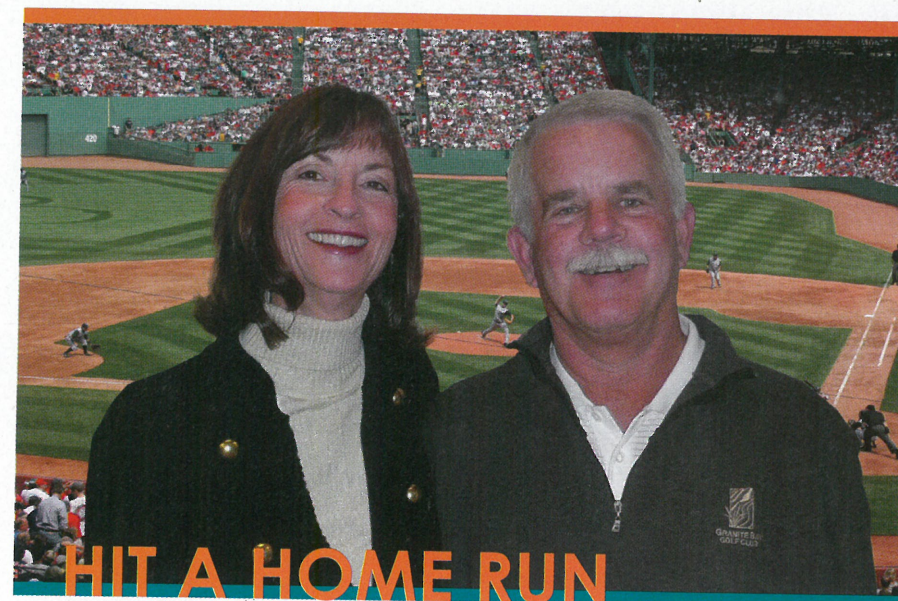
## Imagine the money to be saved if merchants didn't have to pay fees, or if you could circumvent a bank when sending money.

But Brito says the volatility will subside as more people engage with it. "It's volatile because it's a small economy; one trade or a news story can send the market moving." He says it's important to remember that Bitcoin is a platform, and soon "someone will build a killer application" for it and the technology "will be widespread," in part because it's cheaper and faster than debit and credit cards.

Imagine the money to be saved if merchants didn't have to pay transaction fees, for example, or if you could circumvent a bank when sending money to your Dutch uncle. As for other potential uses, some believe there are many, though it's too soon to know exactly what will pan out.

Maybe Ben Bernanke sums it up best. In a November letter to Congress, he wrote, "while these types of innovations may pose risks related to law enforcement and supervisory matters, there are also areas in which they may hold long-term promise, particularly if the innovations promote a faster, more secure and more efficient payment system. That we can buy into.

Jill Coody Smits is an Austin, Texas-based journalist. Find her online at [blueseedcommunications.com](http://blueseedcommunications.com).



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"Right at Home has exceeded our expectations on so many levels, including financially. We recently picked up a second territory."

Tom & Jennifer Bollum  
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<sup>1</sup> There is no assurance that your Franchised Business will do as well as those Offices referenced above. Actual results vary from business to business.  
<sup>2</sup> Net Billings in 2012 for 205 Offices open one year or more as of December 31, 2012. 79 or 39% of these Offices attained or surpassed the represented level of financial performance.  
<sup>3</sup> Average Gross Margin in 2012 of all 205 Offices open one year or more as of December 31, 2012. 110 or 55% of these Offices attained or surpassed the represented level of financial performance.  
<sup>4</sup> Based on Average Net Billings Percent Increase from 2011 to 2012 of 205 Offices open one year or more as of December 31, 2012.  
<sup>5</sup> Source U.S. Department of Health and Human Services