Introduction

By now, everyone has noticed Bitcoin's mercurial 17x rise year-to-date (Ether is up 58x YTD, by the way). Each day, new blockchain companies appear in our newsfeeds. Some firms focus only on blockchain; others are expanding their business offerings with blockchain solutions. Lofty stock appreciation often follows such announcements for public blockchain companies. But beyond cryptocurrency trading exchanges, we've seen few blockchain deployments yet, which begs the question – is blockchain real or is it hype? In short, the answer is "YES" – blockchain is real, but it is early.

Two weeks ago, we attended the Blockchain Expo in Santa Clara, California, an event that brought together over 3,000 people for two days of blockchain discussion. We spoke with industry experts and enthusiasts to find out if blockchain companies have paying customers. After spending 2 days of discussions, we conclude that although blockchain is real, widespread commercialization generally isn't occurring yet. One CIO of a Fortune 100 industrial company – one with an R&D budget bigger than many public company market caps - shared that she's driving blockchain solutions horizontally through her organization to parse inefficiencies. However, her organization has yet to reduce any costs. She added, however, that she believed that this would change in two to three years.

Blockchain on Display

Strolling through the Blockchain Expo exhibition hall, we saw few companies with commercialized blockchain products. New blockchain architectures abounded with many reducing transaction times and others increasing user security, especially around personal data. Above all, initial coin offering (ICO) promotions dominated the hall.

A founder pitches his company at an ICO competition at Blockchain Expo

ICOhhhs

Proceed with caution should you invest in an ICO. We spoke with two cybersecurity experts at Blockchain Expo who have evolved with the industry over decades. Their current venture invests in blockchain projects. And as part of their due diligence process, they review business cases, founder backgrounds, advisor/board member commitment, and code security. These fellows said that for every 50 ICOs they decide to scrutinize, only one is secure. That's one out of the hundreds of files that cross their desks. Their observation parallels conversations that we had with Valley blockchain companies – there is a dearth of blockchain programmers. Just because someone can code, doesn't mean he knows how to write blockchain applications, or she's a cybersecurity expert. Given that the number of enterprises with cyberattack resistant networks hovers around 2%, blockchain security is a big issue beyond the high-profile crypto exchange hacks and thefts that have occurred.

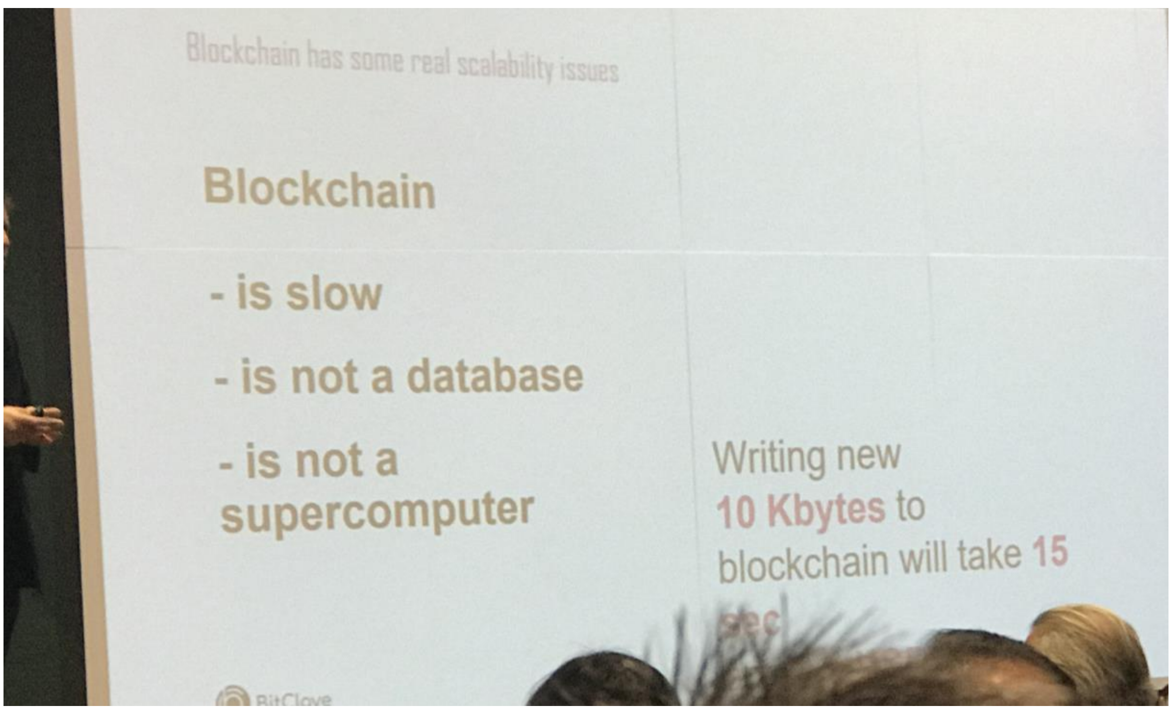
Regulation is Coming

Think about what an ICO actually is: people looking for money to develop an idea as opposed to evolving products, strengthening working capital, selling existing products or services, or acquiring companies.

ICOs raise money to develop blockchain code. Basically, all you need is an idea, a website to publish code, a cryptocurrency wallet to accept funding, and promotional skills. Many companies, both scrupulous and unscrupulous, have taken advantage of this unregulated fundraising method, raising tens and sometimes hundreds of millions of dollars.

ICOs are a real investment vehicle, though. Data presented at a Blockchain Expo panel discussion indicated that over 30% of the people investing in cryptocurrencies and tokens are new to the investment world. Regulators recognize this, and blockchain experts we met believe that U.S.-based ICOs will become regulated within the next year as opposed to banned (as they were in China). Know-Your-Client will become imperative to the process, since we've begun to see a big retail push trying to capitalize on the next token providing stratospheric returns. The cryptocurrency exchanges are still immature, and anyone who has transacted can attest to what a nerve-wracking experience it can be – transactions delayed for days as transaction volume overwhelms blockchain capacity, the safekeeping (or lack thereof) of social insurance and passport info, wallet security and the prevalence of thefts, horrible user interfaces that question whether you've entered the right wallet address (most Bitcoin wallet addresses have 34 characters).

We believe that regulation is a good thing. It will reduce fraud, potentially require exchanges to have investor insurance, and allow governments to track capital gains that aren't being reported. However, with regulation comes a large risk: should ICO regulation occur in the U.S. and ICO tokens become classified as securities, some cryptocurrency exchanges could be in trouble since they are not authorized to trade securities. Some may have to close; others will have to invest to become compliant. This will make most tokens, which already are illiquid, even more illiquid.



Blockchain has scaling issues

Standard Blockchain

The blockchain projects and solutions that we saw at Blockchain Expo were limited to single enterprise deployments. Companies are looking at how blockchain can improve internal operations, and one day, these blockchains will connect to blockchains outside of the enterprise to create real-time supply chains and partitioned identities. Visionaries at Blockchain Expo even discussed how blockchain will allow consumers to bypass gatekeepers like Google, Facebook, AirBnB, and Uber.

Many of these single enterprise blockchain solutions were proprietary. That's a problem if blockchain is to create a network of value, where we transact directly and instantly, get real-time information on anything, and eliminate inefficiencies. We'll have to connect blockchains together to realize this value, and if proprietary blockchains don't have widespread adoption and user-friendly development toolkits, they may not survive.

That's why a lot of companies were talking about adopting open source blockchains. Open source standards for anything facilitate adoption because they facilitate consistency, connectivity, reduced costs, and increased innovation. Coders create, share, and tweak toolkits for the benefit of all. These toolkits then reduce the amount of code other programmers need to develop for a project, saving companies time and development costs. Disparate blockchains may not work together, whereas open standards are almost plug-and-play.

In the blockchain world, Ethereum and Hyperledger are leading open-source contenders that many companies are exploring. At Blockchain Expo, blue chip companies shared the results of their experimentation with these two blockchains. IBM and Oracle were prominent with their Hyperledger promotion and use cases.

Lack of Data Privacy Could Ruin Businesses

Identity will become an increasing theme in the blockchain world. In parallel with this, the cybersecurity risks should be part of your diligence process when evaluating blockchain investments. In Europe, General Data Protection Regulation (GDPR) rules come into effect on May 25, 2018. This means that companies can collect your personal data, but they must protect your data from misuse. Infringement of GDPR laws can result in a fine of up 4% of an enterprise's global revenue. Any company dealing with EU citizen, resident, or business data will have to comply.

Eliminating the Middlemen in Your Portfolio

At this stage, blockchain is mostly confined to R&D projects. Common business cases focus upon elimination of supply chain intermediaries and safeguarding your personal data. Of interest at the Blockchain Expo was how blockchain could disrupt Internet advertising and eliminate gatekeepers. Companies have long dreamed of knowing everything about you, and Google and Facebook are well along that path. They use your information to deliver

Blockchain will change consumer/supplier relationships advertisements to your browser that generate revenue for them. Blockchain Expo speakers discussed scenarios where you will eventually control your data on a blockchain. When we control our data, we will decide who sees what. The IRS does not need the same personal data as your electrical utility, and your employer doesn't need to know what you do in your own time (via Facebook). We could even specify which companies can deliver advertisements to us, and we might make them pay for the privilege. Should we decide to purchase from an advertisement, we could bypass Amazon, Expedia, eBay, or any other middleman transact directly with the supplier.

Current Insurance Regulations Inhibit Blockchain Adoption

Industries that blockchain could revolutionize are inhibited by the inefficiencies blockchain could weed out. Take the insurance industry, for example. When an auto accident occurs, adjusters interview those involved, witnesses, and first responders to gauge what happened to establish the claimant's case. In a blockchain model, insurance companies would get access to dashboard info that automakers collect, telco data and smart city data – factual data that establishes what happened, faster, cheaper and more accurately than adjusters can. But this scenario is unlikely in the U.S., inhibited by 56 regulators that blockchain insurance panelists stated wouldn't give up their control or trust technology with private data.

It's too bad because, interestingly, blockchain allows the insurance model to shift. Instead of dedicated financial companies underwriting policies, why couldn't auto manufacturers do it at the time of a consumer purchase? They would have the dashboard information about the customer's driving habits in the case of an accident. Plus, they know exactly how much one of their vehicles depreciates annually and blockchains could add maintenance data, driving conditions, and smart city info. Access to this data would allow insurers to levy premiums based upon a driver's long-term behaviour rather than actuary estimates. Wouldn't it be nice to have lower premiums if you consistently adhere to driving laws, provable by an immutable blockchain record?

Blockchain enthusiasts lined past noon for free Blockchain Expo passes

Conclusion

Blockchain is real, but it will take some time until it is widely adopted. We believe that open source solutions will be winners. But safeguarding identities is imperative to adoption; so is cybersecurity, and experts we met find security gaps that are vulnerable to hackers in most ICOs. ICO regulation will likely come to the U.S. within a year putting some cryptocurrency exchanges at risk.

Proceed with caution when investing in companies involved in the blockchain. For now, it may be a safer investment strategy to invest in companies that have an existing business that can be transferred or will benefit from blockchain adoption.

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