The rise of BTCs and what this means for financial markets

Alongside an increased focus on ESG and the rise of AI, another trend is emerging in the world of corporate finance. It is the rise of bitcoin treasury companies; confusingly and probably on purpose, referred to as 'BTCs'; an acronym not to be confused with bitcoin 'BTC', the decentralised peer-to-peer digital sound money.

So, what are bitcoin treasury companies (BTCs) and are they relevant to institutional investors?

Whilst every company, charity and pension trust should be thinking about the opportunities and risks of bitcoin to their organisation, BTCs are a special breed of companies listed on a stock market whose primary goal is to raise substantial capital for the purpose of buying bitcoin. And, usually doing so at speed using a mixture of equity and debt.

If an institution is invested in equities or debt, then it may have some exposure to BTCs via the relevant equity or bond index, but currently that exposure will be negligible.

But what's more interesting and relevant is what the existence of BTCs is telling us about the financial markets.

The monetary premium bubble is on the move

Over recent decades, many investments (e.g. equities, real estate and bonds) have been increasingly bought by people to protect the purchasing power of their savings. This is because the money available ($, £, euro), doesn't hold its value over time. These government monies have steadily lost value because their supply is frequently increased, which dilutes the money's purchasing power, and leads to people searching out alternative ways to protect their wealth. In other words, people have had to choose to save in the local government money and get poorer, or to invest their wealth to beat the rising prices of goods and services (in practice, most people do a bit of both). A good money is one where the saver can hold it for long periods with minimal risk and be confident that it will buy roughly the same or more real goods and services when they spend it. An historical example of a good money would be a gold coin.

Therefore, this extra demand for these investments has pushed up their prices. An example of this is housing, which has become unaffordable for many. Similarly, the price of equities is at all time highs relative to the earnings of those companies.

The part of the price that relates to an asset's demand as a savings vehicle is defined as the 'monetary premium'. If there was a good money that could act as a better savings vehicle then these investments would have less demand, and we would see a flow of wealth from these investments to the good money.

Bitcoin is a pure monetary global asset. The world's population should tend towards the best global digital money, but bitcoin is still not widely understood and it will take time for it to be (unevenly) adopted.

So how can the monetary premium move from the equity and bond markets to bitcoin? One answer is companies that tap the equity and bond markets to buy bitcoin, i.e. BTCs. This creates a path to allow capital to flow more easily to bitcoin because many investment mandates or regulations constrain or disallow explicit bitcoin allocations. Separately, other listed entities such as ETFs or investment trusts could allocate to bitcoin, and we could see an acceleration of the outright selling of equities and bonds to buy bitcoin. As a reminder, any entity that is holding bitcoin on your behalf introduces counterparty risk and you could lose all your money if mistakes are made. An analogy is that investing in a gold mining company is not the same as buying gold coins or bars.

As an aside, we are not seeing gold treasury companies emerge because gold is expensive and time consuming to buy and self-custody. Unlike with gold, BTCs can, in theory, raise $1 billion of equity and have $1 billion worth of bitcoin under self-custody an hour later. Moreover, BTCs can do that every day.

What could happen next?

We are likely to see a proliferation of BTCs over the next few years. Some will be well structured and able to ride out and even take advantage of bitcoin's price volatility. Others will jump on the bandwagon with limited understanding, be poorly structured, and go bust during the next bitcoin bear market. Indeed, they may trigger the next bitcoin bear market - if they do, then we expect to see some people reactively blame bitcoin but the reality is that (as usual) poor human governance and greed will be the causes.

Maybe 0.1% of companies will become BTCs (of which many could ultimately fail). The other 99.9% should focus on how best to embed this new monetary technology to improve their existing organisational model.

BTCs are a temporary phenomenon. It will become increasingly difficult to arbitrage the equity and bond markets relative to bitcoin as the monetary premium within those markets reduces. However, we are only at the start of this process and the global monetary premium could be $300 to $500 trillion in real terms (it's impossible to calculate the exact amount). Furthermore, the total monetary premium will grow in fiat money terms as central banks continue to debase their currencies over time.

How should >99.9% of institutions react?

Unless you have the brave view that bitcoin can only go to zero, all institutions should be seriously considering how bitcoin could affect them, including:

- As a treasury asset to protect against fiat money inflation and counterparty risk, and to hedge against the flow of monetary premium out of equity and debt markets (outside of this BTCs phenomenon).
- As a payment rail for cash flows into their organisation (e.g. merchant payments or charity donations), cash flows out (e.g. to suppliers and staff), or within their organisation (e.g. between international subsidiaries).
- As a global liquid form of collateral, for example to use alongside existing collateral such as real estate to strengthen the overall collateral quality.

Note that none of these actions involve actively buying BTCs. A good first step could be to apply your risk register framework to think through the benefits and threats. An in-house or outsourced Chief Bitcoin Officer could bring the necessary senior expertise, focus and project management.

What should the <0.1% of companies do?

BTCs have a fiduciary duty to act in the best interest of shareholders and other stakeholders. This means showing a clear commitment to a well thought through bitcoin accumulation strategy that is appropriately resourced, executed and communicated. This is a new area (except for one such company that started in 2020) and best practice will evolve. However, there is likely to be a heavy focus on innovative but fairly simple financial engineering to raise capital and secure bitcoin custody. Two possible red flags could be lack of commitment to increase bitcoin per share or taking on meaningful counterparty risk to achieve a yield on the bitcoin.

Confusingly, one recently defined term is 'BTC yield' which isn't a yield in the true sense but is instead a measure of how quickly each BTC has accumulated bitcoin per share. More new jargon is likely to emerge, and care will be needed to ensure consistent comparisons across BTCs.

If you would like to discuss any of these matters further, please get in touch with your usual contact at Cartwright.

July 2025

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