# Venture Capital Surges Into Crypto Startups

By **Olga Kharif** and **Camila Russo**
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- Investors seek equity stakes now, coin sale proceeds later
- ‘Security tokens’ expected to grow as regulators move in

As the red-hot initial coin offering market comes under closer scrutiny from regulators, venture capitalist interest in crypto is also picking up.

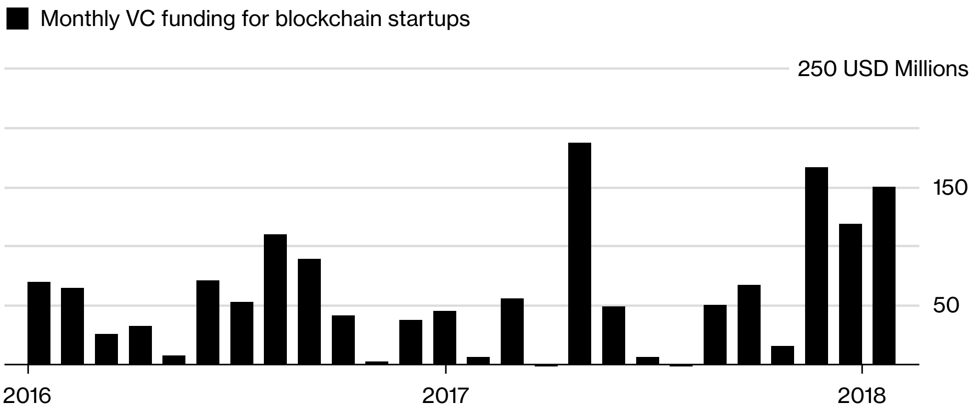
While ICOs were supposed to disrupt venture capital, such funding in blockchain-based companies is surging, with startups raising $434 million since December, the most ever in a three-month period, according to CoinDesk data <https://www.coindesk.com/bitcoin-venture-capital/> .

With the U.S. Securities and Exchange Commission weighing in on the token industry, the venture capitalists’ increased interest in equity reflects a cautious bet that the business will grow.

“If a company goes on and gets an ICO, my equity is worth more,” Frank Meehan, partner at SparkLabs Group, said. “That’s really the game right now.”

### VCs Are Betting on Blockchain Startups

Venture capital funding on blockchain companies picked up in last three months




Source: CoinDesk

The $100 million blockchain fund launched late last year and is part of the SparkLabs <http://www.sparklabsgroup.com/#whoWeAre> Group which has invested in six blockchain companies, Meehan said. If it then invests in a company's ICO, it may get a discount. And that's an investment that can be sold sooner than an equity stake.

Read More: Hedge Funds Flip ICOs <https://www.bloomberg.com/news/articles/2017-10-03/hedge-funds-flip-icos-leaving-other-investors-holding-the-bag>

Token sales continue to boom. Startups raised more than $3 billion through ICOs in just the first two months of the year, more than half of what they took in through all of 2017, according to CoinDesk data.

In 2017, 46 percent of token startups either failed after their ICOs or weren't able to complete funding, according to Bitcoin.com, which drew on statistics gathered by website TokenData. So far this year, 50 of 340 completed ICOs have failed, according to TokenData.

The failure rate isn't all that surprising considering many of these companies are armed with nothing more than a white paper, and don't have a working product <https://www.bloomberg.com/news/articles/2017-12-12/want-to-issue-a-red-hot-ico-rule-no-1-is-do-very-little-work> . They are working with a fledgling technology most of whose applications haven't been tested in mass scale.

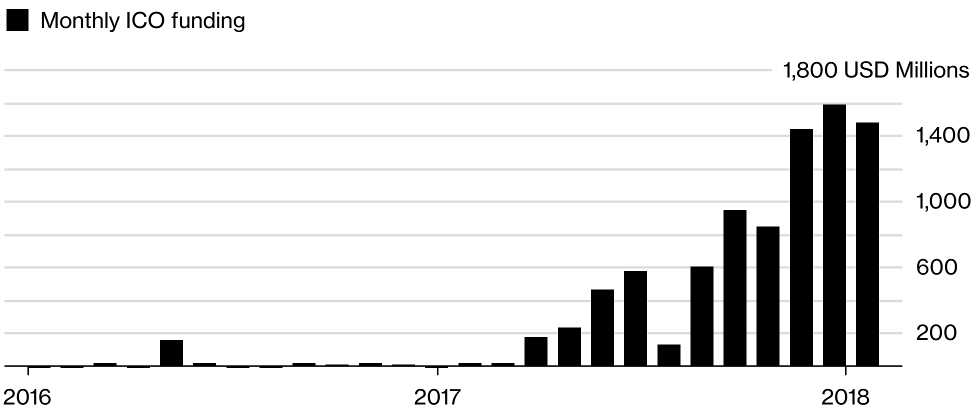
So, some investors would rather wait for companies to establish themselves and to see how market regulation develops. Because many ICO investors increasingly want to invest in more mature companies, these startups need to raise equity to fund product development and marketing.

"It's a good time to be cautious. You're not missing any boats," said Lonne Jaffe, managing director at Insight Venture Partners. "We'll invest once the companies are hitting on all cylinders and are starting to scale up."

Insight Venture is in talks with some of its portfolio companies about how they can use blockchain technology or serve startups in the industry, Jaffe said. The firm has $18 billion in raised capital for more than 300 companies, including Twitter Inc., according to the company.

**What Clampdown?**

Initial coin offering funding is soaring even as regulators tighten grasp




Source: CoinDesk

The regulatory regime for securities is well-established, while the possible regulation of ordinary ICOs is still emerging. In a letter <https://www.bloomberg.com/news/articles/2018-03-06/initial-coin-offerings-likely-need-to-heed-bank-secrecy-rules> made public on March 6, the U.S. Treasury Department said some startups that issue tokens may be deemed money transmitters and will need to comply with bank-secrecy and know-your-customer guidelines. SEC Chairman Jay Clayton said in February that "every ICO I've seen is a security," even though most token startups insist they aren't.

And Monday, social-media company Twitter joined <https://www.bloomberg.com/news/articles/2018-03-26/twitter-joins-facebook-google-in-banning-crypto-coin-sale-ads> Facebook and Google in banning ads for initial coin offerings and coin sales. Industry bellwether Bitcoin fell as much as 8.7 percent.

Many investors, therefore, are more interested in buying tokens linked to equity or other assets -- so-called security tokens -- as a way to reduce regulatory surprises. Investor Jeff Pulver on March 8 announced the Security Token Association, a trade organization in Washington that will focus on tokens classified as securities.

Launched this year, Securitize.io <https://www.securitize.io/> , a platform for issuing tokens tied to things like company equity and revenue, already has more than 100 startups, with plans to raise billions, in its pipeline, according to company co-founder Jamie Finn.

“These models that bring dividends and real payments are very attractive,” Finn said. “We are starting to see big companies, big brands go to market in very interesting ways.”

One company is opting to do an ICO through Securitize rather than go public via Nasdaq, he said. Another, Lottery.com, is planning to share with token holders part of the money raised in the charitable raffle it runs.

Tokens that offer equity typically can be traded more easily than traditional startup equity, which may be tied up for years. Equity-linked tokens can be sold after a lockdown ends, typically closer to one year. Also, they’re sold online and easier to buy, so family offices, for example, can invest in them directly instead of going through funds, Finn said.

For now, hardly any exchanges offer security token trading. One is Templum LLC, an SEC-registered broker-dealer and alternative trading system. Security tokens accounted for a $100 million sliver of the $400 billion crypto market as of last year, according to Polymath Inc., a platform for issuing such tokens. Still, as more institutional investors come on board and regulation tightens, security tokens will come to dominate the market, Polymath CEO Trevor Koverko said.

“We just think ICOs are broken, and probably the SEC is going to have a lot of say about the money that’s been raised,” Joe Forbes, chief executive officer at Causam eXchange, said. “Having built a bunch of companies before and having a real product, why take the risk of raising capital that may have to be given back? Why risk the company’s future on an unknown regulatory situation?”

Instead, on March 8 Causam started selling tokens representing 25 percent of the company to 1,000 U.S. accredited investors. The company, which makes it easier for energy providers to get paid quickly, hopes to raise $15 million. Buyers will be able to sell their tokens after a one-year lockdown. The five-year-old company already has a product, customers and profits, Forbes said.

Jason A. Williams, who already owns equity in Causam, said he planned to participate in the sale. In February, he helped start a $25 million fund at venture firm Full Tilt Capital that will invest in such security tokens.

“This takes a private offering that was historically illiquid and makes it liquid,” he said.