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Easiest Path to Riches on the Web? An Initial Coin Offering

By NATHANIEL POPPER JUNE 23, 2017

A new crop of technology entrepreneurs is forgoing the usual routes to raising money. The entrepreneurs are not pitching venture capitalists, selling stock in an initial public offering or using crowdfunding sites like Kickstarter.

Instead, before they even have a working product, they are creating their own digital currencies and selling so-called coins on the web, sometimes raising tens of millions of dollars in a matter of minutes.

The pitch is that once the products are up and running, the currencies — with names like BAT, Mysterium and Siacoin — will be redeemable for services like data storage or anonymous internet access, and could appreciate in value in the meantime.

Known as initial coin offerings, this latest twist in online fund-raising has made it easier than ever for entrepreneurs to raise large sums of money without dealing with the hassles of regulators, investor protections or accountants.

Since the beginning of the year, 65 projects have raised $522 million in these offerings, according to Smith & Crown, a research firm focused on the new industry.

It is a frothy, sprawling and completely unregulated way of funding start-ups, leaving even veteran technology watchers scratching their heads.

"It's kind of like when you are a little kid and you know you are getting away with something," said Chris Burniske, an industry analyst at ARK Invest. "It's not going to last forever, but it's fun in the interim. The space is giddy right now."

Last month, a small team of computer engineers in Lithuania raised $14 million in 45 minutes by selling a coin, known as Mysterium, that is intended to give access to an encrypted online data service that is still being built.

The next day, a group of coders in the Bay Area pulled in $35 million in under 30 seconds of online fund-raising. The coders were offering Basic Attention Tokens, which will one day work on a new kind of ad-free web browser.

Then this week, a team in Switzerland raised around $100 million for a coin that will be used on an online chat program that has not yet been released, known as Status.

Proponents of initial coin offerings hail them as a financial innovation that empowers developers and gives early investors a chance to share in the profits of a successful new enterprise. But where some see a new method of crowdfunding online projects, critics say the phenomenon is ripe for abuse and, in many cases, a violation of American securities law.

"It's exploitative and abusive of the investing public," Preston Byrne, a technology lawyer specializing in virtual currencies, said about the offerings.

Last year, the first blockbuster coin offering, the Decentralized Autonomous Organization, quickly raised more than $150 million. But the project blew up after a hacker manipulated the code and stole more than $50 million worth of digital currency. A number of other projects since then have been labeled scams.

Even among supporters, many say there has been too much money pouring into unproven projects in recent months.

Fred Wilson, a founder of the venture capital firm Union Square Ventures, said he was "long term very bullish" on these new digital currencies. But he said, "We see many reasons to be cautious right now."

"There is a gold rush mentality in the sector right now and many people are doing the wrong things for the wrong reasons," he said.

Underpinning the surge in initial coin offerings is a broader boom in digital money. Bitcoin and Ether, two of the most popular virtual currencies, have soared in value in recent months. And when entrepreneurs sell new coins, they are asking for payment in Bitcoin or Ether, not United States dollars.

This means that conventional banks and financial institutions are essentially shut out, allowing initial coin offerings to take place beyond the control of regulators.

Among the people tossing their money into the pot is Pete Sussman, 27, a software developer at a St. Louis company called Fusion Marketing.

Mr. Sussman began with around $800 worth of Bitcoin, which he earned selling art and blog posts online. He used his Bitcoin first to invest in a project called BitShares. Then he bought into the Ethereum virtual currency, Ether. As the value of Ether soared over the last year, Mr. Sussman got a return of 1,000 percent on his original money.

In March, he used his Ether to buy a new virtual currency known as GNT, which was created as part of a project known as Golem, based in Poland. The value of GNT has jumped 3,000 percent in recent months, pushing the value of Mr.

Sussman's digital currency to over $200,000.

Along with GNT, other new tokens including Ark, Antshares and Spectrecoin have appreciated by more than 6,000 percent since they were issued.

Mr. Sussman has also had some bad moments along the way, such as the time that he sent what would now be $100,000 worth of Ether to a scammer who put up a fake digital address for another coin offering.

"I was at work. I went to the bathroom and I tried to throw up but nothing came out," Mr. Sussman said. "Then after a little bit, I went home and sulked."

When he told his co-workers about the experience, they did not warn him off the investments. Instead, they became excited about the trend. Now, half a dozen of his colleagues, including his boss, have a chat room where they discuss potential coin investments.

The projects selling coins come in several forms. Some are straightforward start-ups that design their coins like stock, with promised dividend payments if the company does well. Others are Bitcoin or Ethereum knockoffs, which the inventors sell in advance before launching to the public.

But most of the prominent projects are not traditional start-ups. Instead, the programmers are building online services similar to Wikipedia, which are intended to be open source and owned by no one.

The coins will become the internal payment method on these services once they are built — paying for computing power in the case of Golem, or file storage with a project called Storj. The sale of the coins will be used to compensate the programmers.

Even some well-established Silicon Valley names are using coins to raise funds. Brendan Eich, a co-founder of the Mozilla web browser project, is developing a new browser called Brave.

It was Mr. Eich who raised $35 million in just 30 seconds by selling millions of Basic Attention Tokens, or BAT, in late May. People using the Brave browser will be able to use their BAT to view web pages ad-free, and companies will be able to pay viewers for looking at ads. (The New York Times and other publishers have called Brave's ad-blocking technology illegal.)

The hope with a token like BAT is that as more people use the browser and more advertisers want the coins, the coins will become more sought after and the users will benefit from the rising price. These so-called network effects can also encourage users to get their friends to use a service.

Mr. Eich said he was anticipating that all the people holding tokens "will drive millions of users to join our ecosystem."

That is the dream. For now, several projects are raising millions without even having any computer code to test. And because of the lack of investor protections, the projects remain vulnerable to the whims of entrepreneurs, who could run away with their quick hauls of digital currency.

The most immediate problems could arise if regulators decide that the tokens being sold are unregistered securities, a violation of the law. An official with the Securities and Exchange Commission suggested at a conference last month that the agency was aware of the potential for problems and was looking at the market.

For at least some investors, such as Mr. Sussman, the possibility of big losses is the flip side of the big gains, and part of the allure.

"It's very Wild West," he said. "It's very easy to get into a situation where you can send things to a scammer very easily, and there is no recourse for it. That's kind of the beauty of it, too."

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