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Cut to the Chase

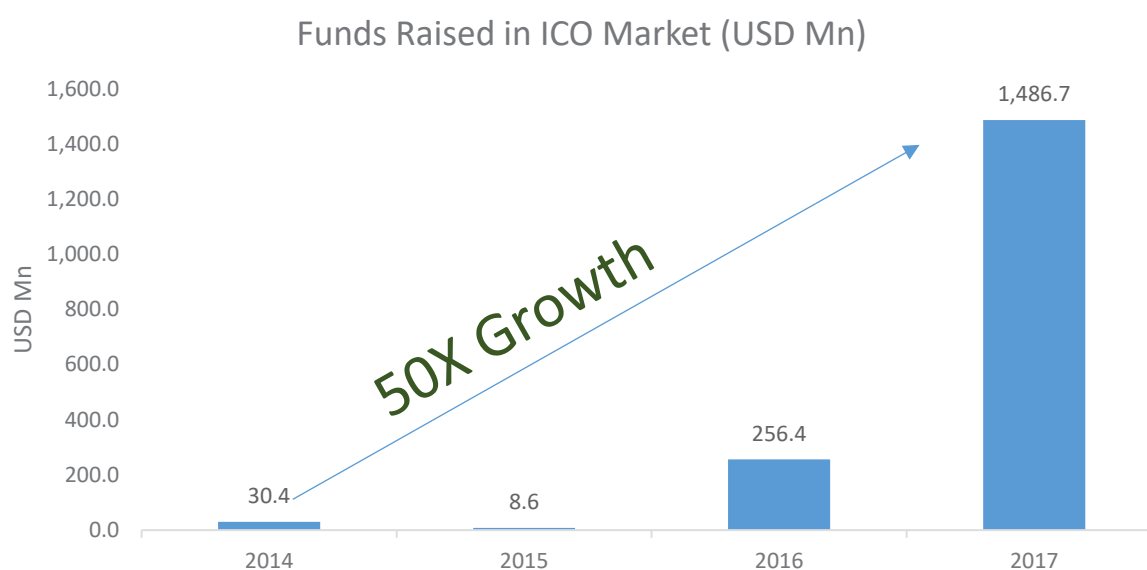
Initial Coin Offering

WHAT is an ICO?

- Initial Coin Offerings are a new fund-raising avenue, popularized by Ethereum, used by start-ups bypassing the stringent IPO requirements (Initial Public Offerings), venture capital scrutiny or the myriad of regulations of debt market. The start-ups offers some units of the new cryptocurrency or a token in exchange, similar to shares in an IPO, for cryptocurrencies like Bitcoin or Ethereum or conventional fiat money to the investors.
- An ICO is closer to a crowd-funding campaign, a minimum goal and a period of time to reach that goal is set. Once the fund raising is successful, the start-up can distribute the token to its investors which could be traded on cryptocurrency exchanges¹.

WHY has it suddenly become so popular among start-ups?

- ICO's are relatively easy and hassle-free way to raise funds as in most of the jurisdictions they are not regulated, doing away with the heavy paperwork required for other fund raising means via conventional channels².
- For blockchain startups, ICOs are a win-win - they allow startups to raise funds without giving up their equity holding and venture capitalists breathing down their necks on spending, prioritizing financial returns over the general good of the product or service itself.
- ICO's have been slowly gaining popularity in the past two years following their debut as a funding mechanism in 2013 owing to the above mentioned factors. Ethereum's successful ICO in 2014 raised USD 18.4Mn and since then opened the flood gates of ICO based investments.



Source: CoinDesk

¹ Provided there is demand for the cryptocurrency/ token that has been distributed

² Regulators are waking up to ICOs as a form of fund raising and are planning regulations in the future. China recently banned ICOs terming them fraudulent

WHERE does the sale of ICO take place?

- The ICO sale itself — at least up until now — is usually been handled in an ad hoc manner, but one that follows a similar rhythm. Usually the project or company will create a website and issue one or more technical white papers describing the project. The company will also describe the total number of tokens and the schedule on which they will be created. Then, the company describes how the proceeds from the token sale are to be distributed to founders, developers, and other participants within the ecosystem they endeavor to create.

HOW does an investor benefit from an ICO?

- In some of the ICOs that are created, the investors gain through a combination of fees for services and freshly minted coins/tokens. Supply of coins is limited — a move that was heavily popularized by Bitcoins. As time progresses, the project has an expectation that the network service providers will earn less income from newly minted tokens and more from tokens paid as fees. If the ecosystem is seen as robust and growing, there is also an expectation that the value of the token will increase.
- For example, a newly opened cake shop gets funded through an ICO process. The tokens would be issued at a price of 1 CKT (Cake token) for certain amount of Bitcoin/Ethereum/US Dollar. If the project is successful, it would give them the access to the cake shops that form part of the chain. With supply capped³, the price of the CKT would increase as more people would try to buy the CKT in order to use it at a cake shop.

³ Supply is capped by using Blockchain from third parties. It is done to ensure that the company does not issue more than the agreed number of bitcoins nor recall the ones that have been issued already.

References

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