Initial Coin Offering

What is the issue?

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- Globally, there has been a silent boom in ICO fund-raising, with much of the action focussed on Europe and North America.
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- With global regulators issuing warnings about this sprawling market, it is essential to understand its working and the risks associated with it.
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What is an Initial Coin Offering (ICO)?

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- An Initial Coin Offering (ICO) is used by the startups to bypass the rigorous and regulated capital-raising process required by venture capitalists or banks.
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- More accurately known as token sales, ICOs are unregulated means of raising money from public investors, to finance a startup.
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How does it work?

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- When a startup firm wants to raise money through an Initial Coin Offering (ICO), it usually creates a plan on a whitepaper.
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- It specifies the following:
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i. what the project is about
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ii. what need(s) the project will fulfil upon completion
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iii. how much money is needed to undertake the venture
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iv. how much of the virtual tokens the pioneers of the project will keep for themselves
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v. what type of money is accepted
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vi. how long the ICO campaign will run for
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- During the ICO campaign, interested public investors buy some of the distributed cryptocoins with fiat or virtual currency.
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- These coins are referred to as 'tokens'.
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- These are much similar to shares of a company sold to investors in an Initial Public Offering (IPO) transaction.
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What are the different kinds?

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- Two kinds of ICOs are active in the market.
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- One type raises money to fund a new virtual currency or blockchain project that aims to reflect the success of the Bitcoin or Ether.
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- These ICOs are attractive with the fact that the tokens can be exchanged for the new virtual currency, once it takes off.
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- The other set of ICOs simply raise money to fund tech startups.
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- Simply, a percentage of the cryptocurrency is sold to early supporters of the project.

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- This is in exchange for legal tender or other cryptocurrencies, but usually for Bitcoin.
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- It represents an informal ownership share in the business they fund.
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- The expectation is that the tokens will appreciate in value with the underlying business.
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How is it different from the IPOs?

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- Essentially, while IPOs deal with investors, ICOs deal with supporters that are keen to invest in a new project.
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- The word 'informal' is key to understanding the concept of ICOs.
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- In an IPO, the rights in the case of shares bought are legally protected by the elaborate securities market regulations.
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- On the other hand, the legal status of ICO 'tokens' is uncertain because many countries, including India, haven't yet framed any regulations in this regard.
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- Also, companies that raise money through IPOs are required to file and get approval for a detailed prospectus from regulators.
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- They are also required to provide ongoing disclosures to investors.
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- ICOs, however, evade all these rules and simply issue a white paper sketching out business plans.
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What is the concern?

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- One of the reasons for the recent interest in ICOs is certainly the multifold rise in prices of virtual currencies such as bitcoins.
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- India is also seeing a spell of startup action around the virtual currency and

blockchain ecosystem.
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- However, the regulatory status of ICOs is not firmly established in India.
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- The RBI has warned investors of the risks of experimenting in virtual currencies and is considering regulating crytocurrencies.
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- On the other hand, SEBI is yet to express its official views on ICOs.
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- Notably, even SEBI's global counterparts are still grappling with the issue of whether to treat digital tokens as 'securities'.
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- Given the absence of any kind of regulatory framework in place, venturing into ICOs would be risky for the public investors.
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- Notably, funds that are lost due to fraudulent initiatives may not be recoverable.
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Source: BusinessLine

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