BBD VIEW

INVESTING IN ICOs

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SHOULD YOU BE **INVESTING IN INITIAL COIN OFFERINGS** JUST YET?

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Initial coin offerings (ICOs), also referred to as token sales, have become the latest fintech trend gaining popularity in the cryptocurrency environment. But what are they? Simply put, ICOs are used to raise investments for a particular project. But instead of traditional equity, investors receive electronic tokens for their investments, confirming their stake in the project.

While this may sound similar to an initial public offering (IPO), ICOs are different:

An **IPO** is used when a privately-owned company with a track record needs to raise capital for future growth plans and offers shares of the company's stock to the public. As part of this process, the company lists on a stock exchange such as the Johannesburg Stock Exchange (JSE) or New York Stock Exchange (NYSE).risk.

ICOs are start-ups, or possibly just a rough idea for a product, written in the form of a white paper describing an idea. More often than not, the solution or product has not yet been built or sold. There is no business track record, other than the expectation being set by the creators. The ICO issues a new token in the form of a cryptocurrency that investors purchase, with the hope that the product gets built and is successful. It is unclear if the investor is actually purchasing equity in the start-up, or just a 'token' to use the service being built at a later date. Other similar examples include angel investing, seed funding rounds from venture capital companies and crowdfunding. I like using an analogy to explain the concept.If my white paper focuses on inventing and developing a bus, I could either sell you a share in the bus company that I'm starting, or I could sell you a ticket or token to ride on the bus. This token doesn't give you partial ownership of the company, but if I develop my bus, you will get a certain number of rides on that bus. These bus tokens, giving you access to the service, are then your ICOs.

It is important to note that issuing equity to the public is highly regulated, hence ICOs are treading a very fine line between issuing equity and issuing tokens. Some ICOs may find themselves on the wrong side of the law and end up with fines or even jail time. Regulators from a range of countries have warned about the unpredictability of ICOs, with China recently banning the use of ICOs as a form of fundraising. Many of the investors in ICOs are often unaware of what they bought, merely hoping that it will increase in value based on what they have seen happen to Bitcoin.

Despite this, there are a few success stories, with Ethereum being an example of a project that was profitable to early investors. Often compared to Bitcoin, Ethereum is a distributed public blockchain network, which uses Ether as a type of crypto token that fuels the network. Ethereum also offers the ability to program smart contracts, which are algorithms that can facilitate the exchange of money, content or anything of value. Using the bus analogy, a smart contract would be an agreement where you would give the driver your bus token if you travel comfortably and safely from Johannesburg to Cape Town. When the conditions of the contract are met, the payment is automatically made.

Even though ICOs can be used to start up useful projects like Ethereum and many others, I am still very cautious of the concept. Investors need to be aware they stand the risk of losing their investment, hence I suggest waiting till ICOs are better regulated before participating.

About Matthew Barnard

Matthew is BBD's Executive Head of Banking and leads the fintech vertical. With a passion for both technology and financial services – his specialities include project management, fintech strategy and solutions architecture.

About BBD

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