

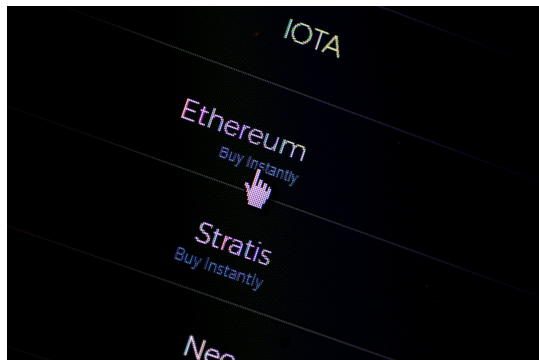
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<https://www.wsj.com/articles/whats-an-initial-coin-offering-icos-explained-in-11-questions-1506936601>

## MARKETS

# What's an Initial Coin Offering? ICOs Explained in 11 Questions

This method of capital raising, which lies somewhere between a traditional initial public stock offering and a crowdfunding, has exploded this year



Cryptocurrencies are seen on a website that tracks the value of initial coin offerings in this illustration photo. PHOTO: THOMAS WHITE/REUTERS

By Paul Vigna

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A new method of capital raising called the initial coin offering has exploded this year. It is a process where tech startups, mainly from inside the digital-currency sector, create a new virtual coin or token and offer it for public sale. It lies somewhere between a traditional initial public stock offering and a crowdfunding. Firms raised a record \$1.32 billion this way in the third quarter alone.

Here are some of the most common questions about the offerings.

### 1. So, what are they?

An initial coin offering, also called an ICO or token offering, is a way for private, generally younger startups, to raise money that goes around the traditional capital markets. Some coin offerings are selling a token that can be used within an online service; some are selling the equivalent of shares in an investment fund. The token can be used to encourage certain uses and goals, which is why some people also call it “programmable money.”

### 2. How does it work?

In an ICO, a company simply creates a new digital currency, and sells it publicly. The original digital currency, bitcoin, is an open-source software project, meaning anybody is welcome to copy to source code and create their own version of it. Another digital-currency platform, Ethereum, standardized the coding for creating a token. That made it easy to create new coins, which is a big reason the field took off.

### 3. How much money are we talking about?

In the third quarter through Wednesday, 105 coin offerings worth \$1.32 billion were sold, according to research firm Token Report. That is more than the \$956 million raised from 67 offerings in the first half of the year. And the year-to-date tally of \$2.27 billion is more than 20 times the roughly \$100 million raised in 2016.

Even though these totals are commonly quoted in dollars, investors generally aren't sending U.S. currency. Instead, investors send bitcoin and Ethereum's native currency, called ether.

Coin offerings have quickly become big enough to be comparable to venture capital fundraising. The \$1.32 billion raised in the third quarter was close to the \$1.41 billion raised by early-stage tech companies, according to data from research firm CB Insights. In the first quarter, these angel and seed-stage venture fundraisings totaled \$1.43 billion, compared with just \$38 million for coin offerings.

#### **4. How big are the individual fundraisings?**

The largest was \$262 million raised by a startup called Protocol Labs for a computer-memory marketplace called Filecoin. San Francisco-based Dynamic Ledger Solutions raised \$232 million for its Tezos ledger-technology service. Before 2017, the largest coin offering was for a project called The DAO which raised \$152 million. But about a third of that money was stolen by hackers.

#### **5. What kinds of companies are doing coin offerings?**

Mainly, tech companies, more narrowly in the cryptocurrency sector. Most of the time, it can be hard for an outsider to even understand the project. On the other hand, a company called Paquarium, raised \$620,000 in a coin offering to build a giant aquarium.

#### **6. What exactly am I buying?**

The ICO coin-offering moniker makes it sound very much like an IPO. That is an initial public offering, often a highly regulated sale of securities. What exactly you are buying in an ICO, though, varies widely. Most of these new assets are designed to provide access to some kind of service or app. In that way, they are like the tokens you used to get at video arcades or pre-sale tickets to a Broadway show. Others are constructed like shares in an investment fund.

#### **7. How do I buy one?**

You'll need one of the digital currencies mentioned earlier, (Ethereum or bitcoin) and a digital wallet. In general, firms conduct the offerings through their own websites, so you'll be sending the digital currency directly to a wallet the firm maintains. But every firm does it somewhat differently, trying to find the best mix of terms. If you miss the offering, many coins will later trade on digital exchanges in the secondary market, much like a stock after its IPO. A warning though: the high volatility can make the penny stocks of old look like a stable T-bill.

#### **8. What does a business need to conduct an ICO?**

On one level, you need the right code, a story to sell and some luck. The reality, though, is it helps to have a product. Perhaps it is an online commerce website or a gaming site. Initial coin offerings have raised millions in minutes, which can be both a blessing or a curse for a new company.

#### **9. How can I tell if a coin offering is legit?**

The easiest way to tell a fraud from a legitimate offering is simple: information. The less provided, the higher the odds of a scam. Does the startup have identifiable ownership? Not all do. Does it have a working product? Does it at least have the code for the product? Does it have outside advisers? Legal counsel? If the company makes vague statements like "we're backed by a major sovereign nation," but won't give specifics, that could be a red flag too.

#### **10. Where are the regulators?**

They've been rushing in. The U.S. Securities and Exchange Commission has taken a recent interest in the coin offerings, and China and Korea recently banned them. Friday, the SEC charged a businessman and two companies with defrauding investors in a pair

of small coin offerings. Regulating the offerings could eventually bring more standardized information that helps investors make better decisions.

## **11. So, if it isn't a scam, I should buy?**

Not so fast. Just because it isn't a scam doesn't mean it will succeed. The success rate for new companies is notoriously low. You may find an investment idea with a promising product, a legitimate, well-meaning team and even, perhaps, celebrity appeal. But the company may still fail to find a market. Many of coin offerings come from people who only started working on their idea weeks ago. Be prepared to endure losses.

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