

Initial Coin Offerings are disrupting how startups are funded – but what are they?

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ICOs: a new way of funding innovation [nomading/Shutterstock](#)

A rapidly growing number of companies are taking advantage of cryptocurrencies to raise massive amounts of funding through what are called [Initial Coin Offerings](#) or ICOs.

It is not just technology companies that are taking advantage of this new form of money raising. Companies that have gone through ICOs, or are planning to, include those involved with real estate, finance and even the [dental industry](#).

Interest in ICOs has accelerated this year with 148 ICOs so far, [raising](#) more than USD\$2.2 billion.

So how does an ICO work?

At the heart of an ICO is the creation of a new “coin” or cryptocurrency that is similar to the most famous of cryptocurrencies, [Bitcoin](#).

Investors that buy into the ICO buy the new coins at a particular starting price. The company keeps all of the money that is initially raised through this sale. And unlike shares, investors do not get any control or say in the running of the company.

They simply hope that the price of the new cryptocurrency will increase and if successful, allow them to sell their investment at a later date.

Many of the ICOs are based on the technology of [Ethereum](#), using a standard called [ERC20](#). Ethereum has the ability to encode

[smart contracts](#)

, which are essentially the ability to execute one or more actions automatically through software

code when certain conditions are met. A simple example of this is releasing money only after a certain date.

Why would the new coin increase in value?

For the ICO cryptocurrency to be worth anything and also increase in value, the currency needs to be part of the company's business model.

If the company's business succeeds, it follows that the value of the currency will increase because there will be more demand. If demand for the currency increases, the value also increases because the supply of the currency is controlled.

[Filecoin](#) is a company that is creating a secure, peer-to-peer file storage service. The storage for this service is provided by anyone who has unused space in return for payments in the Filecoin currency.

The underlying technology that supports this service, the [Inter Planetary File System](#) (IPFS) may be able to provide a solution to the increasing problem of delivering content online, especially streamed content, cheaply and efficiently.

Filecoin [raised](#) USD\$250 million through its ICO in August this year.

Filecoin hasn't started trading on any exchanges yet and the company hasn't launched its operations. Another storage company, [Storj](#), raised USD\$30 million in May. Its coin is trading [above](#) the price at its ICO.

Another interesting model for the use of an ICO is that of [Dentacoin](#), where the coin is used as a form of dental insurance that allows for preventative dental treatment among a network of participating dentists. Dental records can also be shared in this network using blockchain-based electronic health record system.

What are the risks?

Regulators from a range of countries have made [statements](#) about their view of ICOs, warning that they are highly speculative and in the US may run foul of securities laws.

China recently [banned](#) them saying that they were illegal fundraising.

With the heated interest in ICOs, scams and cybercrime associated with ICOs have grown at an equal pace. The [scams range](#) from the possibility of an entire ICO being a fraud to cybercriminals simply taking [advantage](#) of the excitement generated by ICOs to make targeted phishing attacks.

There is also a more basic risk: ICOs are highly speculative and may never result in a viable business, rendering the associated coins valueless. Traditional crowdfunding also carries this risk and so this should be well understood by people buying into both categories of schemes.

It is also the case that buying shares in publicly listed companies also comes with risks, as anyone who [invested](#) in Snap after its launch on the stock exchange knows.

The future for ICOs

For companies that have incorporated a cryptocurrency into their business model, ICOs represent a novel way of crowdfunding that rewards investors if they succeed.

This sets them apart from simply crowdfunding, where the rewards are mostly limited to a product or service in exchange for the money invested, but is not tied to the success of the venture. It also means that the companies can stay private without the external pressures of the market or shareholders.

Given that companies are increasingly trying to use shares with [non-voting rights](#), the benefits of shares over self-issued cryptocurrencies may become less apparent.

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