

Initial Coin Offerings (ICO's) : The Next-Gen Method of Fund Raising

Move over IPO's, there is a new kid on the block called ICO's. A new alternative way to raise capital from the markets which has already created quite a buzz. Soon we will be witnessing ICO's coming into the mainstream and who knows, may also become the primary method for fund raising.



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INTRODUCTION

It has recently been raining IPO's and there has been a steady queue of companies of all shapes and sizes jostling for their two minutes of fame under the sun. In fact, one is seeing many of the tech companies in frenzied activity to go public. Be it Zomato, Cartrade and many others. All these companies have felt that this is the right time to raise funds from the public.

While an IPO is the traditional route to raise funds from the public, there is a new and emerging route that is beginning to pick up pace. The ICO i.e. Initial Coin Offering which has not yet taken the fancy of the startups and tech companies in India. But this route has become one of the primary routes in the western world since the past two / three years and has been gathering pace. It is only a matter of time before we will have the Indian financial market flooded with ICOs.

While a lot is known, understood and written about IPOs, the ICO path is relatively uncharted territory. Through this article, I will attempt to introduce the readers to this new and emerging method of raising funds.

Before we get into the ICO's, it is important to understand crypto currencies and the technology behind them.

CRYPTO-CURRENCIES AND BLOCKCHAIN

Crypto-currencies are digital or virtual currencies. They are the digital equivalent of real world currencies like the Indian Rupee, US Dollar, etc. Just like real world currencies, the owners of crypto-currencies can use their digital currencies to buy goods, services, products, etc. Crypto-currencies are created on the technology called the Blockchain technology.

This Blockchain technology has several unique features with some of the prominent ones being that it is decentralized and is considered highly secure. A blockchain is an incorruptible digital ledger of economic transactions that can be programmed to record, not just financial transactions, but anything of value. Further, since this is not stored in a single location but spread across multiple computers, it is next to impossible to manipulate.

There are at present more than 10,000 different crypto-currencies that are out there being traded. Some of the most prominent of them being Bitcoin and Ethereum. At present, the total market cap of all the crypto-currencies is in the region of approximately USD 2 trillion.

INITIAL COIN OFFERINGS (ICO's)

An initial coin offering is similar in concept to an IPO, both being a process in which companies raise capital. The difference being that while in an IPO, the company issues securities to the investor; in an ICO, the investor will receive a digital coin or a token in return for his / her investment which unlike securities need not have any ownership right in the company.

Tokens / Coins issued from an ICO will have a value and is an asset giving investors access to the features / services of a particular project rather than ownership of the company itself.

It's ultimately the process of crowd funding a new project, involving a token/coin sale, with the project raising capital to fund operations, with investors receiving an allocation of the project's tokens/coins in return. The company can do an ICO either through family / friends or private placement or through the public at large.

ICOs tend to be open from between a few weeks to a month, though some have been open for longer and fund raising for a particular ICO possibly taking place on multiple occasions, unlike an IPO which is a onetime event. This is mainly due to the reason that while the IPO's are strictly regulated, there is almost no regulation for ICO's at present.

THE ICO PROCESS

Although there is no prescribed regulation or method for conducting an ICO, certain common practices have emerged which have been enumerated herein below.

a. White Paper

When a company wants to raise money through an ICO, it usually creates a whitepaper. This whitepaper provides the following information:



- ◆ Overview of the project;
- ◆ The amount of money needed to be raised;
- ◆ What type of money will be accepted;
- ◆ What will be the number of virtual tokens that will be retained by the founders / promoters;
- ◆ What will be the rights attached to the virtual coins / tokens;
- ◆ Duration of the ICO

b. Detailed Roadmap

After the white paper has been published, the company needs to provide a detailed roadmap regarding the development of its project to the proposed investors. This will include the time and cost for each stage of the project. The funding of each stage of the project will have to be allocated in the roadmap as there can be stage wise ICO's.

c. Opening Public Blockchain

This is done in the interest of transparency where all the code of the project is published in the public domain through the public blockchain.

d. Coin/Token Creation and Sale

This means creating the coins / tokens using the blockchain technology and assigning a fair value to the coins / tokens that will be sold and conducting the entire sale process in a fair and transparent manner. It has to be determined as to how many coins / tokens will be sold to the members of the public and what will be the amount that will be retained by the promoters / founders. The company can vary the value of the coins / tokens and can also vary the number of coins / tokens being sold at its discretion.

e. Listing the Coins / Tokens on a crypto exchange

Getting the coins / tokens listed on a reputable crypto exchange brings instant liquidity as trading in the coins/ tokens can commence almost instantly and with increasing trades the price of the coins / tokens can begin rising immediately.

COMPARISON BETWEEN ICO'S AND IPO'S

- i. In an IPO, the investors receive shares for their investment. In an ICO, the investors receive digital coins / tokens but no shares for their investment.
- ii. While the shares issued in an IPO are legally recognized and carry an intrinsic value, the coins / tokens issued

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- in an ICO neither have any intrinsic value nor any legal guarantee.
- iii. IPO's are strictly regulated, however, ICO's are largely unregulated.
 - iv. Companies in India have to comply with SEBI's strict norms and need to have a good track record to be allowed to raise funds through an IPO. However, companies seeking to raise funds through an ICO have no such restrictions.
 - v. An IPO is a one time sale of shares in the lifetime of the company while an ICO can have multiple rounds of varying durations.
 - vi. Due to the IPO's being regulated, they have to follow a rigid structure. However, being mostly unregulated, ICO's do not follow any set structure.
 - vii. The risk factors in an ICO are much higher than those compared to in an IPO. Since ICO's are mostly unregulated there are more chances of scams and fraudulent ICO's.
 - viii. There is also the possibility of a far higher return on investment in an ICO than in the case of an IPO.
 - ix. For investing in an ICO, basic knowledge of crypto-currencies and owning of a crypto-wallet is a must. Also familiarity with the ICO mechanism is crucial.
 - x. In the case of an IPO, audited financial data of the issuer company is available readily in the public domain. However, in the case of an ICO, the investor will have to rely mainly on the white paper issued by the ICO.

CURRENT SCENARIO

ICO's had picked up steam the world over in the year 2017 and similarly, in India as well we saw a few ICO's of startups like WandX, Cashaa and a few others. However, the market dried out as soon as the Reserve Bank of India issued a circular by which it banned all regulated banks from holding or facilitating crypto currency transactions.

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Vide order dated 4th March, 2020, the Hon'ble Supreme Court of India set aside the said circular issued by the Reserve Bank of India. Since then the crypto-currency environment has got a massive boost in India. In fact, when it came to the knowledge of the Reserve Bank of India recently, that several banks were cautioning their customers from dealing in crypto-currencies, the Reserve Bank of India directed all such banks to stop such cautions in light of the said Apex Court judgment. (**Internet & Mobile Association of India vs RBI, Supreme Court. WP(C) 528 of 2018**)

All pointers now indicate to a golden period of crypto-currency and consequently, ICO's in India. In fact, India is already one of the top five countries in the world as far as ownership of crypto-currencies is concerned post the passing of the said Supreme Court judgment.

There have been murmurings that some plans are afoot to bring in regulations with respect to crypto-currencies and that the various agencies of the government i.e. Ministry of Corporate Affairs, Reserve Bank of India, SEBI, etc., are all working in that direction.

With the Government giving a boost to the start-up sector and the boom in various fin-tech, consumer-tech, ed-tech and various other tech start-ups, we will soon see a flood of ICO's. Having some sort of policy in place will go a long way in creating a stable market and also protecting the investors from frauds and fly by night operators.

However, till we actually see some regulation, it's open season and any person wanting to wet his / her fingers in the crypto-currency world needs to do so being well aware of the pit-falls and high risks involved.

Having said that, seeing the way in which various foreign governments and foreign businesses are adopting crypto-currencies and using ICO's to raise funds, it is soon going to be a reality in India sooner rather than later. 