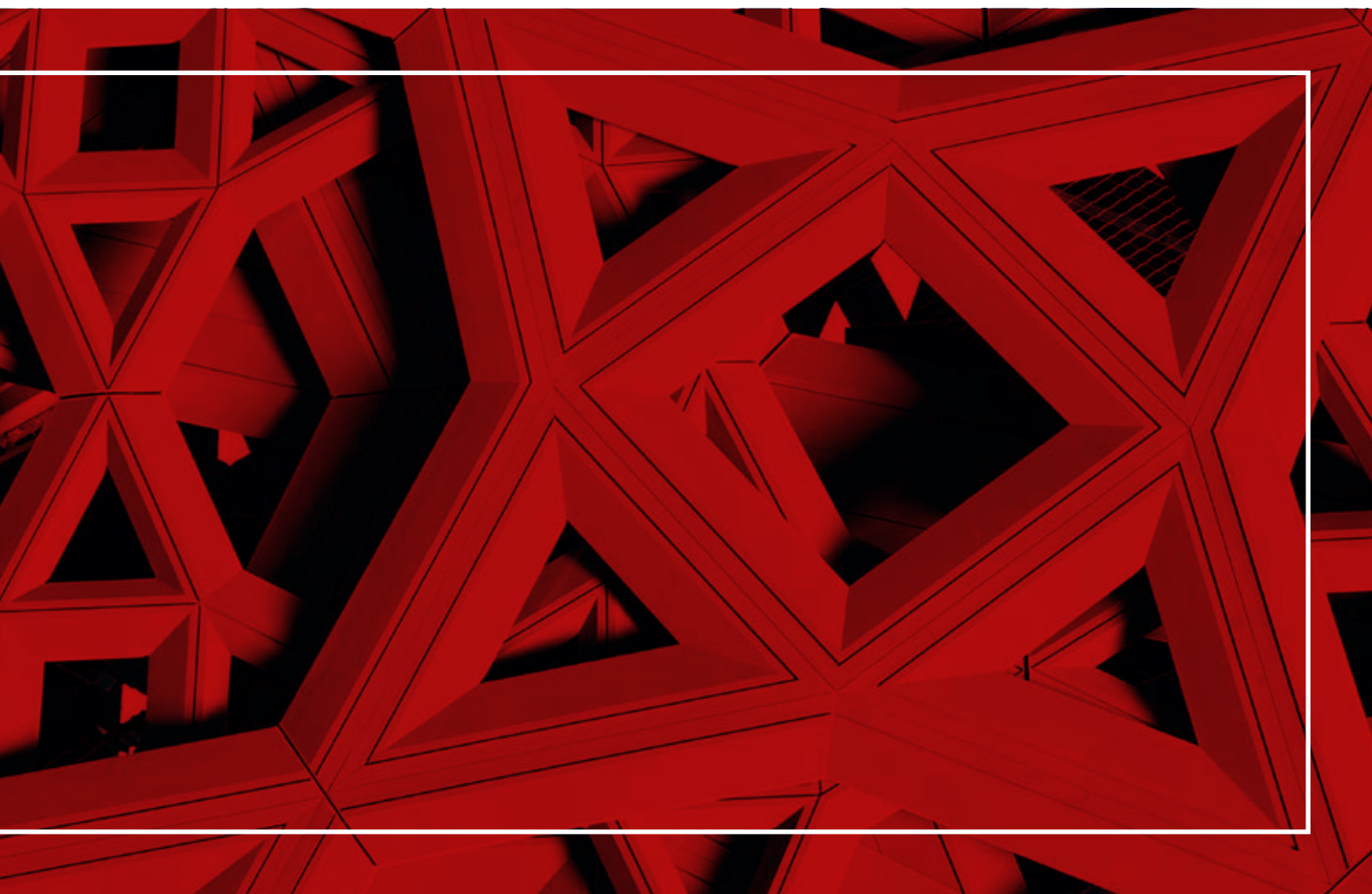


CRYPTOCURRENCY SERIES:

INITIAL COIN OFFERING: WHY MANY ARE A WASTE OF TIME – PART I

JUNE 2018



CAPCO
THE FUTURE. NOW.

INTRODUCTION

In Part I of this paper I discuss why you need to exercise caution when assessing whether to invest in an initial coin offering (ICO). In Part II, I will provide you with the tools to properly assess an ICO based on a comprehensive selection criteria.

As the ICO juggernaut rolls on in 2018, almost unabated, it is important to pause for thought. According to a recent report, ICOs raised more money in the first three months of 2018 than they did in the whole of 2017 - \$6.3 billion to be exact! But with 1,600+ coins and tokens already in the market and continued rumblings of ICO fraud, is an **ICO really worth investing in?**

IT IS INHERENTLY DIFFICULT TO VALUE PIONEERING TECHNOLOGY

When companies raise money through an initial public offering (IPO) they use that money to grow a business. When a company, partnership, community or joint venture raise money through an ICO, they use that money to build a technological infrastructure using blockchain technology with a vision to disrupt a marketplace. Investors in an IPO receive stock benefits (ownership, voting rights, dividends) for parting with their hard-earned cash. Investors in an ICO meanwhile get little more than a digital key – a hash code that proves you own a coin or token.

Valuing cryptocurrencies and their underlying pioneering blockchain technology can be likened to some of the great technology innovations of our time. The last 60 years has seen a major explosion in pioneering technology. In the 1960s it was **IBM** mainframes and **Intel** microprocessors. In the 1970s it was **Oracle** databases. In the 1980s, it was **Dell's** made to order PC which eliminated inventory, **Cisco's** networking equipment and **Microsoft's** operating systems. And of course, the creation of the **World Wide Web** in the 1990s. Now in 2018, it is **Blockchain** technology and **cryptocurrencies** – ground-breaking technology threatening to disrupt and inherently difficult to value.

THE MAJORITY OF ICOs ARE UNLIKELY TO SURVIVE LONG TERM

History suggests, that as technology matures, it will be dominated by a handful of market participants. Amazon and eBay emerged as dominant players from the Dotcom Bubble, leaving many companies in their wake. Extrapolating lessons learned from history indicates that **cryptocurrencies** are no different and that only a **few are likely to survive**. The winners will be determined by rates of user adoption over a long period of time. Amazon was created in 1994, and it wasn't until 2004 when it made its first foray outside of book retailing – some ten years later, that it really started to penetrate a broader market. And it was not until 2015 when Amazon moved into TV production, video and music, that it could truly be regarded as an online behemoth – some 20 years later. Just like Bitcoin, both Amazon and eBay benefited from being first to market.

“ Nearly half of all ICOs launched in 2017 have already failed.¹ ”

MANY ICOs SIMPLY FAIL AND DISAPPEAR

Statistics provided by **TokenData**² and reported by **Brave New Coin**³ suggest that 46 per cent out of 902 blockchain projects that raised money through an ICO in 2017 have already failed. The table below summarizes these findings.

New ICOs in 2017 (count)	902	
Failed at the funding stage	(142)	16%
Failed after the funding stage	(276)	31%
Total failed ICOs in 2017	(418)	46%
Semi-failed ⁴	(113)	13%
Total failed or semi failed ICOs in 2017	(531)	59%

Source: Brave New Coin. March 2018.

¹ [The Ledger. Cryptocurrency. January 2018](#)

² [TokenData](#)

³ [Brave New Coin, March 2018](#)

⁴ Semi-failed = ICO team has stopped communicating or their community deems they have little chance for success

To be fair, these numbers are comparable to **Venture Capital (VC) funded start-ups** where failure rates are reported to be anywhere between 30-75 percent. And depending on which publication you read, this number can be as high as 90 percent. This is also in line with Vitalik Buterin, the founder of Ethereum, who believes that 90 percent of all ICOs will eventually fail. So, given we have 1,600+ coins and tokens right now, which is an all-time high, it might be fair to assume that only 100-150 of these will still exist by 2023.

Unless a new coin/token brings with it groundbreaking technology or innovation (and it will need to be first to market), any new entrants are likely to get lost in the sheer volume of coins. Coins require adoption to be successful.

The only viable alternative to justify so many coins in the long term is if you believe an emerging paradigm - that many disparate ecosystems of tokens will be working independently to disrupt different markets and solving business problems – which certainly seems to be the case at the moment.

MANY ICOs ARE SCAMS


According to research carried out by Statis Group LLC,⁵ **80 percent of ICOs are scams and only 8 percent make it to an exchange.** Their study applied to coins with a market capitalization above \$US 50 million. The US Securities and Exchange Commission (SEC) setup a cyber unit in December 2017 to tackle ICO fraud. It has already made a number of enforcements including one of its highest profile cases to date when the co-founders of Centra Tech raised \$US 32 million through an ICO and made false claims that their debit card was backed by Visa and Mastercard.

Earlier this year, one of the largest ICO scams was exposed when **AriseBank** purportedly raised \$US 600 million and claimed to be a decentralized bank. The co-founders released a false statement that they had purchased a US Federal Deposit Insurance Corporation. They used social media and even an endorsement from celebrity Floyd Mayweather to gain exposure.

A website called **deadcoin.com** tracks deceased coins, hacks and reported scams. It is a virtual graveyard of coins and tokens – over 600 coins had been reported failed, as at September 2017.

ICOs AREN'T REGULATED

ICOs are not regulated. The majority of coin offerings are carefully worded to articulate that they are not offering securities or equity. The few ICOs offering equity or profit share are captured by securities regulation in the USA (US Securities Exchange Act, 1934). The sale of securities (equities) are captured by the **'Howey test'**, which was created by the US Supreme Court to determine whether transactions qualify as 'investment contracts'. This is why many ICOs are issued in Hong Kong, Singapore and Switzerland – to avoid US securities legislation. And why many ICOs are not offered to US citizens. However, ICO regulation is still a very grey area, as buying into an ICO with the expectation of capital growth could still be considered a security in many jurisdictions – this is yet to be properly tested. Expect ICOs to be targeted in 2018/19 by regulatory authorities once cryptocurrency taxonomy and regulatory definition of ICOs become clearer. Many countries are in the process of developing ICO regulation, including Russia.



“ 80 percent of ICOs are scams and only 8 percent make it to an exchange. ”

⁵ [Bitcoin.com](https://www.bitcoin.com), March 2018

ANYONE CAN LAUNCH AN ICO

Raising ICO funds can be as easy as creating a website, issuing a whitepaper and marketing an idea. Once you have raised adequate funding, then you are ready to launch your new token – most likely from the Ethereum blockchain platform, where 90 percent of new tokens have launched. The Ethereum website is user-friendly and provides great support. There are also a number of outsourcers like Coinist.com that can help with a digital wallet, marketing and connecting with investors.

CONCLUSION

With nearly half of all ICOs launched in 2017 having already failed, it would come as little surprise to see a more cautious tone from investors throughout the remainder of 2018. However, it is important to remember that ICO failure rates are comparable to widely accepted failure rates within the VC industry. Rates may appear abnormally high if considered without perspective.

Stay tuned for the second part of this paper, where I will explore what a good ICO looks like and then take a deep dive into what you need to look out for when considering an ICO investment.

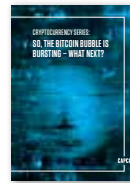
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“ Just prior to banning ICOs in October 2017, over 80% of the world’s Bitcoin trading and ICO financing took place in China.⁶ ”

⁶ [South China Morning Post, 4 December 2017](#)

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