

# How initial coin offerings can reinvent themselves



While improved methods of raising capital for blockchain start-ups such as initial coin offering versions of securitisation, loan procurement and staged financing are still in their infancy, and examples of start-ups choosing these alternatives are limited, innovations like these represent the future of fund raising for blockchain start-ups.  
PHOTO: EPA-EFE

Securitisation, loan procurement and staged financing are some methods ICO firms can explore to win investor confidence

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In late May, Singapore regulators clamped down on initial coin offerings (ICOs), ordering one issuer to stop the offering of its digital tokens and eight exchanges to cease trading these tokens.

Although the Monetary Authority of Singapore did not publicly name the issuer involved, it said the move was to halt the issuing of digital tokens that resembled securities or futures contracts, but which did not follow the legal procedures required of regular securities and futures.

This has caused some observers to wonder about the future of this innovative fund-raising method in what had become the largest ICO market in Asia.

In 2017, start-ups raised roughly US\$5 billion (S\$6.8 billion) worldwide through ICOs, surpassing traditional venture capital funding and transforming the early stage fund-raising landscape. Yet in the same period, roughly half of the attempted ICOs failed to get off the ground.

Many blockchain companies have

focused solely on developing the technology, hoping that the tech alone will drive market adoption. However, as it became clear that a sizeable majority of ICO companies either could not deliver on their promises or simply never had any intention of doing so, disgruntled investors have led calls for stronger regulation.

## Reinventing ICOs

To meet these demands and reduce the risk of fraud and failure, how can ICOs reinvent themselves to win investor confidence?

The long history of finance theory and practice provides useful hints. For example, securitisation, loan procurement and staged financing have been successfully used for public and private companies for decades.

Can these well-established methods serve as prototypes in the blockchain environment? What are the pros and cons of these security designs? Finally, can they be modified and adapted to blockchain companies?

The answer is simpler than it seems.

## SECURITISATION

Based on the concept of securitisation of assets, profits or revenues generated by blockchain companies, the Security Token Offering method represents a regulated ICO that strictly complies with finance laws.

The benefits are improved efficiency, liquidity and transparency, and often include certain features such as proxy voting.

Since any investment including real estate, stocks, bonds, commodities and even infrastructure projects can be securitised (or tokenised), the market value for tokenised securities could potentially reach hundreds of trillions of dollars.

While securitisation provides investors with more assurance, as securities have clearly defined intrinsic value and the company is required to disclose investment risk, newly issued tokens require an underwriter as well as compliance with laws and legal requirements.

## LOAN PROCUREMENT

Another innovative way to raise funds for blockchain companies is through initial loan procurement –

a method that allows blockchain start-ups to enter loan agreements with creditors through smart contracts.

Just like in a typical loan agreement, the issuer has a legal obligation to return investor funds plus pre-determined interest over the maturity of the loan.

Unlike other methods, they are typically more tax efficient and compliant than ICOs and token holders become creditors since they lend money to a company.

It has other advantages in that it is regulatory compliant and the loans are not subject to tax. Further, the immutability of blockchain technology provides confidence to creditors.

## STAGED FINANCING

Well-known in the venture capital playbook, the staged financing method consists of two different phases: the fund-raising phase, where the start-ups raise funds; and the fund disbursement phase, in which the funds are released to entrepreneurs after reaching pre-determined milestones.

Similarly, its blockchain counter-

part – Decentralised Autonomous ICO (Daico) – serves to mitigate some of the shortcomings of standard ICOs by enabling investors to influence how the ICO funds are spent.

It does this by including provisions that the ICO company would have to reach agreed targets before accessing portions of raised funds. In cases where it does not, investors would be able to vote on a refund.

By giving investors control over the funds, this approach limits the possibility of a scam and ensures that the project developers sustain both their motivation and accountability.

Finally, just like staged financing, Daico alleviates risks for investors.

## What's next

With many ICO start-ups failing to deliver on their promises, the crypto community is focusing its attention on how to eliminate fraud, comply with regulations and boost investor confidence.

At the same time, the growing interest of institutional investors in ICOs is fuelling demand for better

regulations and improved governance. This increased scrutiny is pushing potential ICO issuers to strengthen their technical development teams with legal, finance and business professionals.

The likely consequence is further development and adoption of improved methods of raising capital for blockchain start-ups such as ICO versions of securitisation, loan procurement and staged financing.

While these methods are still in their infancy and examples of start-ups choosing these alternatives are limited, innovations like these represent the future of fund raising for blockchain start-ups.

For investors, keeping abreast and informed of these rapidly evolving models will be the key to success.

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