Marketing behind ICO. Part I.

The goal of this article is: “To explain, how is the Crypto World working Today, why is this such a hot topic at the moment and how the companies are using marketing before and during the emission of new crypto currency or new token. The method used for writing this article was mainly internet research, listening of different presentations of experts in this field and discussions with people that are trading crypto currencies, or they already did some ICO. This is totally new market that some people compare with Jungle or Clondyke as the situation and the rules are still changing here. This field has their own language with their terminology that sounds new and unfamiliar for newcomers, but it has their logic and it is possible to learn it fast. Only a group of people understand this problematic right and there is still many questions also from people that are doing with cryptocurrencies some time. If the readers of this article that never worked with crypto before will understand at least the basics of crypto problematics after the reading of this article, the goal of this article will be reached.

Cryptocurrencies have expanded since the days bitcoin shared some of the media’s spotlight with litecoin and the silly-by-design dogecoin. Now, there are dozens of cryptocurrencies worth eight figures, and the birth pace of new entrants is accelerating. In that particular milieu of freshly launched coins is a newly famous transaction type we need to understand called the “Initial Coin Offering” or ICO.

What is ICO

An ICO is akin to an IPO, but in temporal reverse (sort of). Although confusing, it has recently acquired prominence as a favored way to launch a new cryptocurrency. An ICO is a fundraising tool that trades future cryptocoins in exchange for cryptocurrencies of immediate, liquid value. Investors give the ICO bitcoin or ethereum, and they will get some of New Super Great Coin that is going to be emitted.

The Financial Times calls ICOs “unregulated issuances of cryptocoins where investors can raise money in bitcoin or other cryptocurrencies,” which is accurate, especially if you underline the word “unregulated.” (Techcrunch 2017)

ICO is a new financial instrument that is coming out of the bitcoin community. It is also known as “token sales.” This new fundraising phenomenon is being fueled by a convergence of blockchain technology, new wealth, clever entrepreneurs, and crypto-investors who are backing blockchain-fueled ideas. ICOs present both benefits and disadvantages, as well as threats and opportunities, to the traditional venture capital business model.

Here’s how an ICO typically works: A new cryptocurrency is created on a protocol such as Counterparty, Ethereum, or Openledger, and a value is arbitrarily determined by the startup team behind the ICO based on what they think the network is worth at its current stage. Then, via price dynamics determined by market supply and demand, the value is settled on by the network of participants, rather than by a central authority or government.

Venture capitalists, who generally have been standoffish to the ICO phenomenon, are now becoming more interested in it for a number of reasons. One is profits - cryptocurrency investors made some massive returns in 2016, with cryptocurrencies from Blockchain startups Monero and NEM both...
seeing 2,000% increases in value. For example, the cryptocurrency used for the Ethereum network, called Ether, saw its value double in just a few days in March 2017. In three days, people who invested in Ether doubled their investment. Those investors can opt to cash out to a fiat-backed currency, or wait for the cryptocurrency to continue to rise (or fall). Volatility is a two-way street. While the price of Ether has been rising, Bitcoin has dropped 20% to 1,000 USD from a record 1,290 USD on March 3, 2017. (Kastelein 2017)

Today when I am writing this article November 26, 2017 the value of Bitcoin is: 9,024 USD (on November 26, 2016 it was 735 USD - so its value grew 1,228% during last year and the value of Ethereum is 466.21 USD (it was 19,46 USD on March 3, 2017 and 8.17 USD on January 1, 2017, 5.58 USD December 5, 2016 - that is 83.55 times more as almost year ago, so 8355% grow during less that last 12 months). It is normal for cryptocurrencies, that they use to made 10-20-30 sometimes 60-100% in one day, but they are also falling down very quickly, but if someone is buying tokens in ICO, he/she is buying usually for that best price sometimes in price less than 1cent for a token and they expect 2k-3k-10k % growth, so e.g. from 1 invested dollar they could have thousands of dollars, from 1000 USD they can have millions.

Another example is Slovak company called Decent. They had their ICO for 8 weeks between September 11, 2016 and November 6, 2016 and they raised 5,881 BTC for 38,510,759.7675 DCT tokens. That was value that time around 411,670 USD. So the value of the tokens at the end of ICO was 0.1068973976 USD. They went to crypto exchange in December 2016 with the price of token 0.11 USD. So by just entering on exchange, ICO investors had 10% profit. Today November 26, 2017 the value of one token is 0.804245 USD the company value today is 41,262,666 USD but there were days in May, June, July 2017 when the DCT token value was 7-9 USD for one DCT and for short time it jumped at 37.22 USD. ICO investors whose sold DCT for that highest value in July 2017 earned 372.2 USD for each token that they had, so 3722 USD for each dollar that they invested (372 200% in 9 months), ICO participants that sold DCT for e.g. 7 USD earned 70 USD for each token, so 700 USD from each invested dollar (that is 70 000%), but even ICO participants that are still holding DCT they have 8 USD from each dollar that they invested. That is 800% and the price of DCT is growing again thanks the commercial activity that this startup is doing. (data collected from: ICO Tracker.net, Decent and Coinmarketcap.com)

Price of tokens use to grow also during the ICO. Eg. SophiaTX ICO, that is in December 2017 (sophiatx.com) is in 5 rounds and in each round the price will be 10% higher. This is a marketing step, that should bring investors to 1st round and to make them invest as soon as possible.

Figure 1: ICO sale rounds
Source: internal SophiaTX documentation (2017)

So as you can see from this examples, no other financial instrument at the moment can earn you so quickly so much money. This is the reason, why even if the investing to ICO is very risky, people are still investing to it. Risky is because many ICOs are scams or are unsuccessful.

The second reason investors are becoming more interested in ICOs is because of the liquidity of cryptocurrencies. Rather than tying up vast amounts of funds in a unicorn startup and waiting for the long play – an IPO or an acquisition – investors can see gains more quickly, and can pull profits out more easily, via ICOs. They simply need to convert their cryptocurrency profits into Bitcoin or Ether
on any of the cryptocurrency exchanges that carry it, and then it’s easily converted to fiat currency via online services such as Coinsbank or Coinbase.

What traditional investors don’t like about any of this is the regulatory uncertainty; the high valuations and over-capitalization; the lack of control over financials, strategy, and operations; and the lack of business use-cases. And like any industry, the ICO arena has had its fair share of outright scams, pump and dumps, and blatant Ponzi schemes. However, much of the criminal activity is now being mitigated by self-organized, crowdsourced due diligence in the community, as well as by external parties such as Smith and Crown, a research group focused on cryptofinance, and ICO Rating, a ratings agency that issues independent analytical research on blockchain-based companies.

At least one VC firm is moving into cryptocurrencies. Blockchain Capital is set to raise its third fund via a digital token offering in the first-ever liquidity-enhanced venture capital fund (where people can invest without locking their money up for years on end) via a digital token called BCAP.

ICOs are the Wild West of financing - they sit in a grey zone where the U.S. Securities and Exchange Commission (SEC) and many other regulatory bodies are still investigating them. The main problem is, though, that most ICO’s don’t actually offer equity in start-up ventures; instead, they only offer discounts on cryptocurrencies before they hit the exchanges. Therefore, they don’t fit into the current definition of a security, and are technically outside of traditional legal frameworks.

Secondly, they are global instruments – not national ones – and they are funded using bitcoin, ether and other cryptocurrencies that are not controlled by any central authority or bank. Anyone can invest, and they can even do so pseudo-anonymously (it’s not impossible to find out who these people are, but it’s not easy, either). Currently, there’s no Anti-Money Laundering (AML) law or Know Your Customer (KYC) framework, though some companies are working on that. (Kastelein 2017)

The ideal ICO

Over the past couple of months we have seen many ICOs being announced and launched. Some of these have been very successful in raising the funds they needed. Others have found it very difficult to attract the investors and funding they required. The unbridled success of certain projects has led some to believe that raising funds through an ICO is easy. Unfortunately, they are wrong: ICOs are not a way to get easy money. Attracting other people’s money to support your project is tough – and it should be tough! But isn’t an ICO only a whitepaper and a nice website? What are the success factors that differentiate good ICOs from bad ones? The ideal ICO has:

1. A team with proven ability to execute.
2. Business viability check.
3. Technology check.
4. Efficient use of funds and business-based thresholds for minimum and maximum raise.
5. A defined legal framework.
7. A transparent ICO process.
8. Escrow.
9. Controlled release of funds.
10. Delayed founder liquidity.

Our criteria boil down to the following key requirements for success: team, market, and business. The rest are safety, security and credibility criteria that add additional assurance to the investors – but only if you get the fundamentals right. Another thing to note is the importance of timing. It is much harder to quantify, but good timing can be the difference between barely making the ICO threshold or reaching the cap.

We can use the example of Decent, whose raised 4 138 BTC from 5 881 totally raised BTC in first
Main drawbacks: Crowdsale mechanics – The bonus structure, which promised a 50% bonus the first day up to the minimum funding threshold, together with a declining exchange rate created a huge incentive for first day participation, but a very low incentive for later participation (indicated by the fact that around half of all funds raised in the first day of the 8 week ICO period).

Technology check – An IT project operating with blockchain technologies absolutely must get the core ICO technical platform to work flawlessly, otherwise there can be trust issues around the technical capabilities. (Zakrisson 2016)

William Mougayar, author of the definitive work on this topic “The Business Blockchain”, recently structured the key differences between ownership model, entry phases, exit method, business model, legal structure, LP mix, fund currency and market approach. He points out: “I see the two models as diametrically opposed: one is a closed market, dominated by command-and-control practices, led by a few rich people on Sand Hill Road. The other is a widely open global market where anyone can play, and where the gains and risks are more evenly distributed.” (Mougayar 2016)

What we need is a combination of the best of both worlds:

• Decentralization elements: smart contracts, global fundraising, instant liquidity, simple issuing of dividends, simple voting, focus on vision and entrepreneurship and not on bureaucracy and formalities.
• VC elements: structure, coaching, evaluation, commitment, supporting functions (non-tech), milestones, investor protection.

Figure 2: The ideal ICO positioning
Source: Batagelj (2016)

End of Part I.

Literatúra/List of References

Kľúčové slová/Key Words
ICO, kryptomena, sociálne siete, komunity, TGE, tokeny, predaj davu

JEL klasifikácia/JEL Classification
M39

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