

**Audit Committee News**

Edition 65 / Q2 2019 / Corporate Governance

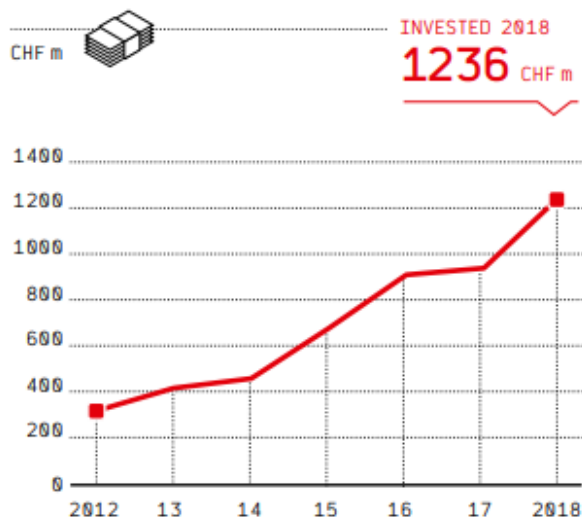
# Innovative Finance

**Decentralized Ledger Technology  
supports Crowdfunding**

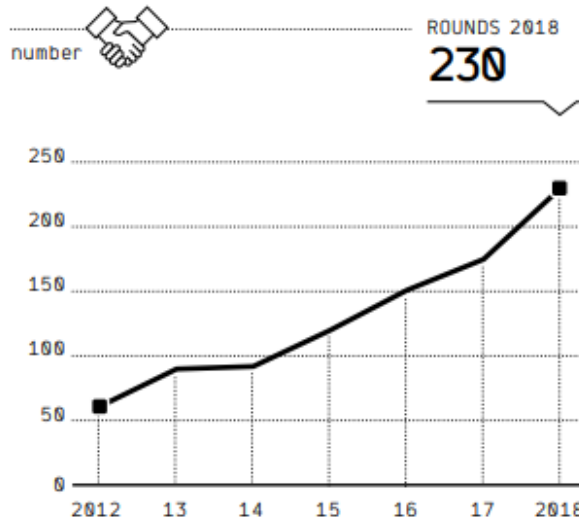


2018 was a bumper year for Venture Capital (VC) investments with over USD 254 billion of VC funding raised globally, compared with USD 174 billion in 2017. In Switzerland, the situation was equally bright: in 2018, nearly CHF 1.24 billion flowed into Swiss startups. However, funding is becoming increasingly demanding for early-stage projects, which is why some of them are turning towards crowdfunding.

### Invested capital in Swiss start-ups



### Financing rounds of Swiss start-ups



Source: Swiss Venture Capital Report 2018

While figures looked promising in general, financing of early stage projects (regardless of the industry) remained challenging, with VCs increasingly focusing on fewer but bigger deals. Many of the biggest VC funds have substantial capital at their fingertips and yet, investors are increasingly cautious with how they are allocating their funding. The decline in early-stage funding has forced many companies seeking investments to provide for stronger business cases, proof-of-concepts and paths to profitability (Source: KPMG Venture Pulse).

### An Alternative to Angels and VCs – Crowdfunding

For many years already, there is an alternative to traditional Business Angels and Early-Stage VCs in the form of crowdfunding. Crowdfunding refers to the practice of raising funds, usually by small contributions from a large number of persons through an online platform to support a project or venture. In most cases, the project will be state a goal of minimum funds to be raised on the platform in order for the project to be launched. There are four main categories of crowdfunding:

- **Crowddonating:** project financiers donate funds without expecting anything in return.
- **Crowdsupporting:** the financing of a project takes place in exchange for a reward.
- **Crowdlending:** the platform operator connects companies or individuals wishing to borrow funds to third parties, which are neither banks, nor financial intermediaries.

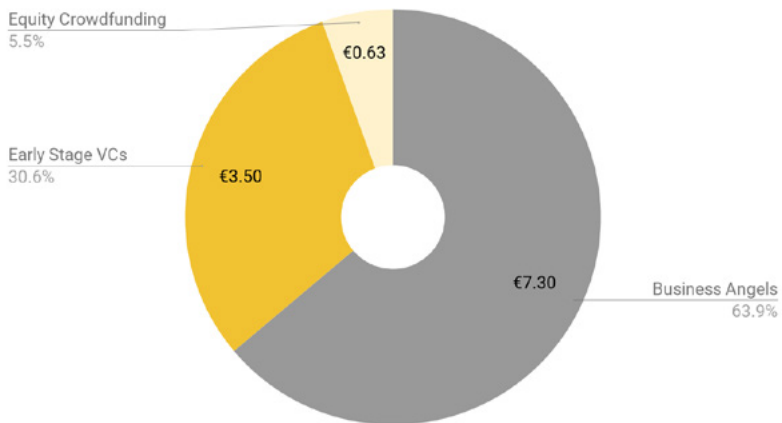
- **Crowdinvesting:** funds are invested in a company in exchange for a stake in this company, usually in the form of equity or other types of securities, granting the right to a portion of the company's profits.

The first crowdfunding platform in Switzerland was founded in 2008. In the meantime, more than forty platforms are domiciled in Switzerland. The volume of funding reported by Swiss crowdfunding platforms shows a positive trend in the past year, with the CHF 100 million barrier first broken in 2016. By 2017, volume increased almost threefold to now stand at CHF 374.5 million.

However, when comparing the various crowdfunding segments with their respective market categories (e.g. consumer credit market, SME credit market, venture capital investments, donations), it becomes clear that crowdfunding's market share continues to quite small (Source: Swiss Crowdfunding Monitor 2018).

The European Trade Association for Business Angels, Seed Funds and Early Stage Market Players, EBAN, estimates that in 2017, only 5.5% of all early equity stage investments was raised with crowdfunding in Europe. Note however that these figures only include crowd investment and do not reflect a new form of funding, which can be described as crypto crowdfunding.

## Early Stage Investment Market



Early Stage Investment Market in Europe (EBAN)

### From “Classical” Crowdfunding to Crypto Crowdfunding (ICO)

In 2016, a new form of crowdfunding emerged based on crypto currencies. Companies focusing on decentralized ledger technology and blockchain started to launch crowdfunding campaigns online instead of raising funds in fiat money (CHF, USD, etc.). Funds were raised in the form of popular crypto currencies, such as Bitcoin or Ethereum. This form of fundraising was quickly labeled Initial Coin Offering (ICO) in analogy to IPOs.

An ICO raises money by selling newly minted digital currency or “tokens”. These tokens entitle the holder to use resources provided by other participants in the network or to purchase products and services within a network. Other digital currencies are more like a payment instrument (for instance, Bitcoin), allowing for an easy transfer of the token among participants in a network created for this purpose and following a set of rules laid out in a computer code. Finally, tokens can also represent equity or debt to fund a new idea or organization.

Similar to a “classical” crowdfunding campaign, the crypto crowdfunding model is based on the idea of community. Most projects founded in the past year involved some sort of decentralized business model where a community of participants could actively contribute to the growth of an ecosystem. Typical examples of such projects are shared data storage systems or operational models that connect Internet of Things (IoT) devices. Other applications may be found in the gaming industry, where rewards can be tokenized and exchanged.

A crowdfunding campaign generates more valuable information than typical fundraising. It gives entrepreneurs a sense of the demand for their product or service and time to tweak the design based on feedback from contributors before investing in production, reducing the risk of wasted time, money, and effort spent on a product no one wants (Source: Peterson Institute). On the negative side, however, crowdfunded projects generally lack the support and supervision by experienced angel- or early-stage investors, which is why a combination of both funding models might be advisable.





### Increased liquidity through Crypto Exchangers

The essential difference between «classical» and crypto crowdfunding projects lies in the fact that tokens can be traded on so-called crypto exchangers. Crypto exchangers are electronic platforms where utility tokens, which represent a product or a service or payment tokens, can be traded. Traditional crowdfunding models, on the contrary, generally do not offer the possibility of buying and selling tokens. For ICOs, however, the possibility of buying and selling tokens on an exchanger platform essentially makes for its attractiveness as a fundraising model.

A number of different protocols, led by Bitcoin and Ethereum, emerged in the past years, allowing for an easy way start such crypto crowdfunding campaigns. The effect was enormous. Within a few month, hundreds of projects around the world started such crowdfunding projects, raising billions of funds.

### Switzerland and the Crypto Valley Brand

In 2017, Zug, the so-called “Crypto Valley” became the global center for crypto crowdfunding. A large number of very prominent blockchain protocols, including Ethereum, Golem, Bancor, Tezos, along with crypto exchangers, such as Lykke or Shapeshift, were launched in Zug or moved their operations there.

Switzerland, and specifically the enthusiastic and energetic crypto and DLT community in Zug successfully launched the global “Crypto Valley Zug” brand. Switzerland’s attractiveness for crypto business comes from a

competitive tax system for the taxation of the proceeds from ICOs. In addition, the Swiss Financial Market Supervisory Authority FINMA published regulatory guidance for ICOs in February 2018, which added regulatory certainty for ICOs and further increased Switzerland’s reputation as one of the most crypto-friendly jurisdictions in the world.

Between 2017 and 2018, dozens of crypto crowdfunding projects were launched in Switzerland and hundreds around the world, raising large sums of crypto currencies (at the time worth billions of USD. Switzerland quickly ranked as one of the top countries in the world for raising funds via an ICO.

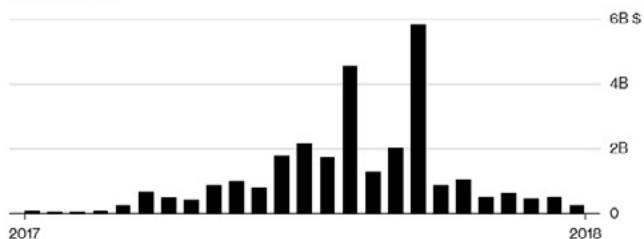
### Top countries by raised funds

<b>#1 USA</b>	\$7.4B
<b>#2 British Virgin Islands</b>	\$2.4B
<b>#3 Singapore</b>	\$2.2B
<b>#4 Switzerland</b>	\$1.8B
<b>#5 UK</b>	\$1.3B

Source: ICO Bench

By mid-2018 however, crypto crowdfunding started to lose its attractiveness. Launching an ICO, which was quite easy in the early days, became more regulated and therefore more expensive while marketing costs skyrocketed. Attracting token buyers became complicated and many ICO projects had to be abandoned because of a lack of funding. From its peak of several thousand projects each week, the global ICO market collapsed to currently only a few projects that seek to raise funds with an ICO, see chart below.

**Funds Raised via ICOs by Month**  
In U.S. dollars



Source: Bloomberg / CoinSchedule

## What's next?

### Utility Tokens

While many believe that ICOs are a thing of the past, there are nonetheless reasonable expectations that crypto crowdfunding might survive. Since crypto crowdfunding is basically not much different than "classical" crowdfunding but offers additional liquidity for token buyers because it is possible to list them on exchanger platforms, it is quite likely that the market for ICOs will recover in the months to come. New projects with clear business strategies and more experienced management teams are already starting to test the waters for fundraising by issuing utility tokens. In fourth quarter of 2018, still ca 120 ICOs were launched globally. About 70 companies are holding token sales in the first quarter of 2019, according to data compiled by CoinSchedule.com for Bloomberg.

### STOs

Another trend is also gaining traction. Instead of selling tokens that give access to services or products (ie. utility tokens), some small and mid-sized enterprises (SMEs) are seeking to raise funds through crypto crowd-investment projects. Buyers of such tokens expect a return on investment i.e. in form of dividends or interests. Such a fundraising project is commonly known as Securities Token Offering (STO). Unlike utility tokens, crypto assets that are tokenized versions of traditional assets fit well within existing regulatory frameworks, which may mitigate some regulatory uncertainties surrounding new crypto assets such as payment and utilities tokens.

Tokenization of traditional assets such as shares or bonds can also help increase liquidity, codify rules and regulations, and increase transparency throughout the asset lifecycle.



Several trading platforms have emerged in the past month in Switzerland. They facilitate easy creation of asset and securities tokens and also offer (decentralized) trading facilities for such tokens as well as digitized and automated shareholder records. By tokenizing shares or participation certificates and selling them on a block chain, SMEs and start-ups can gain easy and inexpensive access to global investors.

### Hybrid Financing

Finally, there is another trend – the combination of the issuance of utility tokens with a traditional equity investment. In this case, a company issues tokens or shares either simultaneously or gradually. While such a financing model might lead to a conflict of interest between token holders, for shareholders it may offer interesting risk mitigation and growth opportunities. Token holders can benefit from managerial supervision by equity investors, while equity investors could benefit from the non-dilutive funding boost that token holders provide. While this is not yet a pervasive financing model, there are already a few examples of such hybrid financing models in Switzerland and elsewhere (Source: The Relationship between Shares and Tokens – Gordon Povey).

## Stable Coins: Game Changers

In the past, one of the important issues with ICOs was the enormous volatility of the value of the funds once they were raised. As a result, projects could not properly plan the allocation of the funds. To mitigate such volatility there are currently several projects underway to launch so-called stable coins, which are pegged to fiat currencies. The latest example is the JP Morgan Coin which is aimed at supporting large transactions for corporate clients but might, going forward also be used for i.e. for dividend payments for tokenized shares. Other initiatives such as the Utility Settlement Coin Project (USC) are also aiming at facilitation payments in relation to crypto assets. Once these stable coins are fully functional they will significantly boost the acceptance of crypto crowdfunding and crowd investment among a larger group of investors

## Summary

Initial Coin Offering and crypto currencies have been hyped massively, leading many serious investors and entrepreneurs to believe that such a financing model is not sustainable. However, upon taking a closer look at the model, it is clear that crypto crowdfunding is not very different from «classical» crowdfunding that is currently expanding moderately. Since utility tokens are convenient for investors and fund seekers alike, due to the possibility to trade them exchangers, it is quite likely that ICOs with utility tokens will prevail for project financing. In addition, crypto crowd-investing in the form of STOs will quite likely gain traction in the months to come. Finally, the combination of equity and utility token financing will provide for interesting new hybrid financing models. However, in order to be perceived as a valid alternative to traditional investment models such a financing model will require the broad acceptance of stable coins (Source: KPMG Institutionalization of Cryptoassets).



**André Guedel**

Senior Manager, Head of International Headquarters Cluster

## Sources

### Bloomberg, February 2019: ICOs Alive and Well as Crypto Startups Go After Wealthy Buyer

<https://www.bloomberg.com/news/articles/2019-02-13/icos-alive-and-well-as-crypto-startups-go-after-wealthy-buyers>

### European Trade Association for Business Angels, Seed Funds and Early Stage Market Players, EBAN

<http://www.eban.org/2017-annual-eban-statistics-compendium>

### ICO Bench

<https://icobench.com/>

### Initial Coin Offerings Require New Regulations – Peterson Institute

<https://piie.com/blogs/realtime-economic-issues-watch/initial-coin-offerings-require-new-regulations>

### José Rodríguez: About the Relationship Between Stablecoins and Security Tokens

<https://hackernoon.com/about-the-relationship-between-stablecoins-and-security-tokens-a26e43f15d9a>

### KPMG: FINMA ICO Guidelines

<https://home.kpmg/ch/en/home/insights/2018/03/how-finmas-ico-guidelines-impact-future-icos-in-switzerland.html>

### KPMG: Institutionalization of Cryptoassets

<https://home.kpmg/content/dam/kpmg/sg/pdf/2018/11/Institutionalization-of-Cryptocurrencies-Whitepaper.pdf>

### KPMG Venture Pulse

<https://assets.kpmg/content/dam/kpmg/xx/pdf/2019/01/kpmgwventure-pulse-q4-2018.pdf>

### Swiss Crowd Funding Monitor 2018

<https://blog.hslu.ch/retailbanking/crowdfunding/>

### Swiss Fintech News

<http://fintechnews.ch>

### Swiss Venture Capital Report 2018

<https://www.startupticker.ch/en/swiss-venture-capital-report>

### The Relationship between Shares and Tokens – Gordon Povey

<https://medium.com/coinmonks/the-relationship-between-shares-and-tokens-in-private-companies-3e5a115e97f>

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received, or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation. The scope of any potential collaboration with audit clients is defined by regulatory requirements governing auditor independence. If you would like to know more about how KPMG AG processes personal data, please read our Privacy Policy, which you can find on our homepage at [www.kpmg.ch](http://www.kpmg.ch).

© 2019 KPMG AG is a subsidiary of KPMG Holding AG, which is a member of the KPMG network of independent firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss legal entity. All rights reserved.