

# Mining pool network and decentralization of a PoW blockchains

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## Abstract

The Proof-of-Work (PoW) blockchain relies on miners who incur constant operational costs while receiving stochastic rewards. To mitigate financial uncertainty, many miners join Pay-per-Share (PPS) mining pools, which provide stable payouts while transferring risk to pool managers. This paper analyzes miners' strategic choices using an expected discounted dividend approach. The pool managers surplus is modelled by a two-sided jump processes for which we show that barrier strategies are optimal under specific conditions. Numerical methods to determine optimal barriers and dividends are provided. Finally, we explore miner distributions across pools and investigate Nash equilibria, providing insights into competitive dynamics. Our findings contribute to understanding how economic incentives influence miner participation and the decentralization of PoW blockchain networks.

## 1 Introduction

The Proof-of-Work (PoW) blockchain consensus mechanism, as first introduced by ?, forms the foundation of decentralized cryptocurrencies such as Bitcoin. This system relies on miners who expend computational resources to validate transactions and secure the network. However, mining is characterized by a dual-risk structure: miners face a constant operational cost (electricity, hardware maintenance) while their rewards—block subsidies and transaction fees—are inherently stochastic and infrequent. This financial uncertainty poses a significant challenge, as it directly impacts the sustainability of individual miners.

To mitigate this volatility, miners often choose to join mining pools. These pools aggregate computational power, distribute rewards more predictably, and ensure more stable revenue streams. Among the various pooling strategies, the Pay-per-Share (PPS) model [???] provides miners with a fixed payout per valid share they contribute, effectively transferring risk to the pool manager.

Miners must make a strategic decision regarding participation in a mining pool, balancing expected revenue against the risk of ruin. This decision can be analyzed using an expected discounted dividend approach, which evaluates the long-term viability of miners given their financial constraints. In this context, optimal dividend strategies, such as the barrier strategy [?], emerge as critical tools for sustaining miner operations and maximizing profitability. These strategies rely on results from fluctuation theory and scale functions [?] to determine optimal capital retention and payout policies.

While extensive research exists on individual miner strategies, the surplus process of the pool manager remains relatively unexplored. It can be modeled as a two-sided jump process, incorporating incoming miner contributions and outgoing payouts. However, existing literature provides limited results on optimal surplus management in this setting. In this paper, we establish that a band strategy is optimal in general and that a simple barrier strategy becomes under certain restrictions. We further develop numerical methods to identify the optimal barrier level and compute corresponding dividends.

Beyond individual miner and pool manager strategies, we leverage our findings to analyze the equilibrium distribution of miners across available mining pools. By considering a set of miners and a set of pool managers, we derive insights into how miners allocate their computational power in response to different payout schemes and risk profiles. Our study further extends to a numerical investigation of Nash equilibria, illustrating the strategic interactions between miners and pool managers in a competitive setting.

This research contributes to the ongoing discourse on decentralization in PoW blockchains. By providing a framework for mining pool strategies and decision-making, we offer insights into how economic incentives shape miner participation, thereby influencing the overall decentralization and stability of blockchain networks.

## 2 Wealth processes and dividends for miner and pool managers

A miner is characterized by her hashpower  $\lambda$  and her operational cost  $c$ . A PPS deal is characterized by a difficulty reeducation  $\delta$  and a pool fee  $f$ .

## 2.1 Miners' wealth process

- Solo mining, the wealth of a miner is given by

$$X_t = x - c \cdot t + N_t \cdot b, \text{ for } t \geq 0, \quad (1)$$

where  $c$  is the operational cost of the miner,  $(N_t)_{t \geq 0}$  is a Poisson process with intensity  $\lambda$  and  $b$  is the block reward.

- Mining in one pool with characteristics  $(\delta, f)$ , the wealth of the pool miner is given by

$$\tilde{X}_t = x - c \cdot t + \tilde{N}_t \cdot \tilde{b}, \text{ for } t \geq 0, \quad (2)$$

where  $(N_t)_{t \geq 0}$  is a Poisson process with intensity  $\tilde{\lambda} = \lambda/\delta$  and  $\tilde{b} = (1-f) \cdot b \cdot \delta$  is the share reward.

- Mining in several pool: The wealth of a miner that splits her hashpower between several PPS mining pool with characteristics  $(\delta_k, f_k)_{k=1,\dots,n}$  according to a weight vector

$$w = \begin{pmatrix} w_0 & w_1 & \dots & w_n \end{pmatrix} \in \Delta^n,$$

where  $\Delta^n = \{w \in \mathbb{R}^{n+1}; \sum_{i=0}^n w_i = 1\}$  represents the unit simplex, is given by

$$X_t = x - c \cdot t + \sum_{i=1}^{N_t} B_i, \quad (3)$$

where

- $(N_t)_{t \geq 0}$  is a Poisson process with intensity  $\mu = \sum_{k=0}^n \mu_k$  and  $\mu_k = \frac{\lambda w_k}{\delta_k}$ , for  $k = 0, \dots, n$ .
- the  $B_i$  values form a sequence of independent and identically distributed random variables with the following distribution

$$\mathbb{P}(B = (1-f_k) \cdot b \cdot \delta_k) = \frac{\mu_k}{\mu} = p_k, \text{ for } k = 0, \dots, n.$$

## 2.2 Pool managers' wealth process

A PPS pool manager attracts miners by offering them PPS deals characterized by  $(\delta_k, f_k)_{k=1,\dots,n}$ . Miners then decide to invest or not in these PPS deals. The results is that the pools collects a hashpower  $\lambda$  splitted according to a weight vector

$$w = \begin{pmatrix} w_1 & w_2 & \dots & w_n \end{pmatrix} \in \Delta^{n-1}.$$

The rate of arrival of each type of share is

$$\mu_k = \frac{w_k \lambda}{\delta_k}, k = 1, \dots, n,$$

A share from PPS deal  $k$  has probability  $\delta_k/(1 + \delta_k)$  of being an actual solution. The wealth of the pool manager is given by

$$Y_t = y + \sum_{i=1}^{M_t} V_i, \quad (4)$$

where

- $(M_t)_{t \geq 0}$  is a Poisson process with intensity  $\mu = \sum_{k=1}^n \mu_k$
- The  $V_i$ 's are iid with probability distribution

$$\mathbb{P}(V = -b \cdot (1 - f_k) \cdot \delta_k) = \frac{\mu_k}{\mu} \frac{1}{1 + \delta_k}, \text{ and } \mathbb{P}(V = b - b \cdot (1 - f_k) \cdot \delta_k) = \frac{\mu_k}{\mu} \frac{\delta_k}{1 + \delta_k}, \text{ for } k = 1, \dots, n.$$

**Assumption 1.** We assume that each mining pool is only offering one type of PPS deal  $(\delta, f)$  to the miners.

[Assumption 1](#) affects the distribution of the  $V_i$ 's which simplifies to

$$\mathbb{P}(V = -w) = \frac{1}{1 + \delta}, \text{ and } \mathbb{P}(V = b - w) = \frac{\delta}{1 + \delta},$$

where  $w = b \cdot (1 - f) \cdot \delta$  denotes the reward for finding a share. The manager's jump sizes are  $\{-w, b - w\}$ .

The drift condition is expressed as

$$\text{drift} = p(b - w) - qw > 0, \quad (5)$$

with  $p = \frac{\delta}{1 + \delta}$ ,  $q = 1 - p$ , and  $w = b(1 - f)\delta$ . Substituting these expressions into (6) leads to the inequality

$$\delta > \frac{w}{b - w}. \quad (6)$$

These equations matter because they keep the problem in an integer domain. In practice, the jump intensity  $\mu(f)$  emerges from miners' aggregate actions, with each miner's choice to enter or exit a pool driven by the contract pair  $(f, \delta)$  set by the manager. The next section presents a criterion, based on a mean-variance trade-off, to determine a miner's entry decision.

### 3 Mean-variance trade-offs optimization

#### 3.1 Miner's mean-variance allocation among multiple mining venues

We consider a miner  $i$  who may distribute fractions of her computational power among several mutually exclusive mining modes. Let

$$w_i = (w_{i,0}, w_{i,1}, \dots, w_{i,n}), \quad w_{i,k} \geq 0, \quad \sum_{k=0}^n w_{i,k} = 1,$$

denote the vector of hashing weights allocated to solo mining ( $k = 0$ ) and to each available pool ( $k \geq 1$ ). Allocation is continuous: the miner may simultaneously participate in several pools by splitting her hashrate across venues.

Each mode  $k$  is characterized by an effective Poisson intensity  $\lambda_{i,k}$  and a reward rate  $b_k$ , both of which depend on the contractual parameters  $(f_k, \delta_k)$  whenever  $k$  corresponds to a pool. For a mining period normalised to  $T = 1$ , we model the (unscaled) payoff from venue  $k$  as a random variable  $X_{i,k}$  with

$$\mathbb{E}[X_{i,k}] = \lambda_{i,k} b_k, \quad \text{Var}(X_{i,k}) = \lambda_{i,k} b_k^2.$$

If the miner allocates a fraction  $w_{i,k}$  of her hashrate to venue  $k$ , the corresponding position contributes  $w_{i,k} X_{i,k}$  to total wealth. Assuming independence across venues, the miner's total reward is

$$X_i = \sum_{k=0}^n w_{i,k} X_{i,k},$$

so that

$$\mathbb{E}[X_i] = \sum_{k=0}^n w_{i,k} \mathbb{E}[X_{i,k}] = \sum_{k=0}^n w_{i,k} \lambda_{i,k} b_k,$$

and, using  $\text{Var}\left(\sum_k w_{i,k} X_{i,k}\right) = \sum_k w_{i,k}^2 \text{Var}(X_{i,k})$  under independence,

$$\text{Var}(X_i) = \sum_{k=0}^n w_{i,k}^2 \text{Var}(X_{i,k}) = \sum_{k=0}^n w_{i,k}^2 \lambda_{i,k} b_k^2.$$

The miner evaluates allocations according to a mean–variance criterion

$$J_i(w_i) = \mathbb{E}[X_i] - \gamma_i \text{Var}(X_i),$$

with risk aversion parameter  $\gamma_i \in (0, 1)$ . Under the above specification, this becomes

$$J_i(w_i) = \sum_{k=0}^n w_{i,k} \lambda_{i,k} b_k - \gamma_i \sum_{k=0}^n w_{i,k}^2 \lambda_{i,k} b_k^2.$$

The miner's optimal allocation solves the constrained optimisation problem

$$\max_{w_i \in \Delta^n} \left\{ \sum_{k=0}^n w_{i,k} \lambda_{i,k} b_k - \gamma_i \sum_{k=0}^n w_{i,k}^2 \lambda_{i,k} b_k^2 \right\}, \quad (7)$$

where  $\Delta^n$  denotes the  $n$ -dimensional unit simplex. This formulation yields smooth, potentially interior solutions whenever several venues simultaneously offer competitive risk–return profiles. In this framework, mining decisions are no longer binary. Instead of entering or exiting a pool, each miner continuously adjusts the proportion of hashrate allocated to every available venue.

This modelling choice produces an endogenous, differentiable hashrate supply for each pool,

$$H_k = \sum_i \lambda_i w_{i,k},$$

which responds smoothly to contractual parameters  $(f_k, \delta_k)$ . Hence, pool managers face a continuously adjusting population of miners whose participation intensities shift in response to the risk–return characteristics encoded in the pools' contracts.

### 3.2 Pool Manager's mean-variance trade-off

For a given time horizon  $T \geq 0$ , the expected wealth of the pool manager associated to wealth process (4) is given by

$$\mathbb{E}(Y_t) = y + \mu t \frac{b\delta}{1+\delta} (f(1+\delta) - \delta). \quad (8)$$

and the variance of the wealth is given by

$$\text{Var}(Y_t) = \mu t \left[ \frac{b^2(1-f)^2\delta^2}{1+\delta} + \frac{b^2\delta(1-(1-f)\delta)^2}{1+\delta} \right]. \quad (9)$$

The pool manager seeks to maximize a mean-variance criterion of expected wealth,

$$J_{\text{mana}} = \mathbb{E}[Z_T] - \eta \text{Var}[Z_T], \quad (10)$$

where  $\eta \in (0, 1)$  denotes as the risk aversion coefficient of the pool manager. Let  $T = 1$  in (20) and using (18) and (19) this yield the objective function

$$J_{\text{mana}} = y + \mu \frac{b\delta}{1+\delta} \left[ f(1+\delta) - \delta - \gamma b \left( \delta(1-f)^2 + (1-(1-f)\delta)^2 \right) \right]. \quad (11)$$

### 3.3 Miner Participation as Follower Reaction

For any contractual pair  $(f, \delta)$ , some miners will join the pool while the others mine solo according to their mean-variance criteria. The aggregate Hashrate contributed by entering miners is therefore

$$H_k(f, \delta) = \sum_i \lambda_i w_{i,k}, \quad (12)$$

The induced share-arrival intensity of the surplus process is

$$\mu(f, \delta) = \frac{H(f, \delta)}{\delta}, \quad (13)$$

so that the pool intensity  $\mu(f)$  depends jointly on the mechanical factor  $(1-f)$  and on the behavioral composition of entrants through  $H(f, \delta)$ . Hence, using (17) and (18), the pool manager's objective function becomes

$$J_{\text{mana}} = y + H(f, \delta) \frac{b\delta}{\delta(1+\delta)} \left[ f(1+\delta) - \delta - \gamma b \left( \delta(1-f)^2 + (1-(1-f)\delta)^2 \right) \right]. \quad (14)$$

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## References