Peer-to-Peer Equity Financing: Contract Design

Xuedong He[1], Sang Hu[2], and Steven Kou[3]

[1]Department of Systems Engineering and Engineering Management, Chinese University of Hong Kong, Hong Kong SAR, China. E-mail: xdhe@se.cuhk.edu.hk
[2]School of Science and Engineering, Chinese University of Hong Kong, Shenzhen Campus, China. E-mail: husang@cuhk.edu.cn
[3]Department of Finance, Questrom School of Business, Boston University, 595 Commonwealth Ave., Boston, MA 02215, U.S.A. E-mail: kou@bu.edu

Abstract

In peer-to-peer equity financing entrepreneurs can raise capital privately (e.g. hedge fund financing) or publicly (e.g. via initial coin offerings) without traditional financial intermediaries. To overcome the information asymmetry between entrepreneurs and funders, we propose an incentive contract that can attract some entrepreneurs who are attractive from the funders' perspective and deter all entrepreneurs who are unappealing to the funders. In contrast to standard screening contracts, our contract neither depends explicitly on the utilities of the principal and agent nor has a menu of choices. Two case studies are given, one for hedge funds and one for initial coin offerings.

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Keywords: P2P financing, contract design, performance fees, first-loss, liquidation boundary

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