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“Entrepreneurial Incentives and the Role of Initial Coin Offerings”

Initial coin offerings (ICOs) are a new mode of financing start-ups that saw an explosion in popularity in 2017 but declined in popularity in the second half of 2018 as regulatory pressure, instances of fraud and reports of poor performance began to undermine their reputation. We examine whether ICOs are a passing fad or a worthwhile form of financing with beneficial economic properties. We do so by examining how financing a start-up through an ICO changes the incentives of an entrepreneur relative to debt and venture capital financing. Depending on market characteristics, an ICO can result in a better or worse alignment of the interests of the entrepreneur and the investors compared with conventional modes of financing. Notably, an ICO can be the only form of financing that induces optimal effort and hence maximizes the net present value of the start-up, and there are projects that should not take place at all unless they can be financed through an ICO.