FEATURE ARTICLE

Case in disruption: LexShares and the litigation finance sector

Christoph Lattemann | Ilan Alon | Emily Patig

[Short Abstract for Table of Contents]

At the intersection of FinTech, crowdsourcing, and crowdfunding, LexShares has created a unique business model that offers a new way of linking the various stakeholders in the litigation finance sector. Will its template for the disintermediation of the banking sector prompt firms in other industries to follow suit?

[Long abstract:]

Specializing in crowdfunding litigation via a web-based platform, LexShares is part of a new generation of businesses designed to take advantage of the opportunities for disintermediation offered by the digitization of the economy. By connecting investors directly to plaintiffs and lawyers, LexShares has created an alternative financial investment product that is not dependent on the performance of traditional financial markets. Its business model shows how a single company can revolutionize its business sector by introducing and leveraging a disruptive technology. The company’s experiences in the realm of litigation finance offer myriad lessons for business leaders seeking a competitive edge and new markets in any sector.

**[Text begins here.]**

# [H1] Introduction

In a 2015 interview via Skype, Jay Greenberg, co-founder and chief executive officer of LexShares, recalled how a 2013 conversation with a colleague in their bank’s corporate finance offices in London gave rise to his firm.

His colleague said, “Hey, Jay, this is a ridiculous conversation, but I’m thinking about suing some people. You know, I walk down the street every day and I see great opportunities for lawsuits. The problem is, if I go to my attorney he will want a quarter million dollars to do the research to see if the case is viable.”

Greenberg said he laughed and answered, “I don't have a quarter million dollars for you.” His colleague replied, “That’s not the point. My point is why can’t we get a bunch of people to pull together that quarter million dollars and, then, when we win the lawsuit, we split it between us”

Intrigued by the concept, Greenberg eventually replied, “That’s one of the strangest ideas I have ever heard, but intrinsically, it makes a bit of sense to me!” Thus, LexShares—and what Greenberg terms “third-party investments in unrelated commercial legal claims,” essentially an alternative financial investment product that has little or no correlation to the financial markets — came to be.

After conducting some research, Greenberg contacted Max Volsky, who in 2013 had written *Investing in Justice: An Introduction to Legal Finance, Lawsuit Advances and Litigation Funding*. In January 2014, they formed LexShares, a Boston-based platform where fund seekers could access capital and private investors could obtain financing for commercial legal cases. To be listed on LexShares, legal cases must have a funding requirement of at least $100,000 and no more than $1 million (see **Exhibit 1**).

[PRODUCTION: Set Exhibit 1 about here]

LexShares is a FinTech crowdfunding company—FinTech because it uses computer technology to support financial services, and crowdfunding because it collects small amounts of money from a large group of people. By adopting new technologies and business innovations, LexShares allows investors with no connection to a particular lawsuit to invest in a plaintiff's claim in exchange for a share of the rewards if the case is successfully prosecuted. This has come to be known as litigation finance. Since its founding in 2014, LexShares has created a unique competitive advantage for itself and, like many other institutions, has contributed to disintermediation in the financial sector.

# [H1] Litigation finance: AN OVERVIEW

A relatively new concept, litigation finance enables funders who have no direct connection to a lawsuit to invest in a plaintiff’s claim in exchange for a share of whatever is ultimately recovered (Krause, 2015; Robertson, 2011). “The lender agrees to pay the legal costs — win or lose —including any adverse, court-ordered costs the plaintiff may be ordered to pay, such as attorney fees, in a losing effort. Should the case prove successful in winning a settlement or damages, the financing firm gets a big piece of the pie” (Van Voorhis, 2017, p. 10). This means that the lawsuit is “treated as an asset and is used to collateralize investment in initiatives that might be completely unrelated to the underlying matter” (Rowles-Davies, 2016, p. 28).

Although technological and informational innovations, which remove barriers to entry and grant access to new customer groups, have contributed to the rise of litigation finance (Rodak, 2006), an information gap still exists. Crowdfunding in litigation finance is not often discussed among academics, investors, or fund seekers. When assessing the future of litigation finance, attorneys often tend to focus on trends, such as increased service provider competitiveness, that generate pressure to innovate and create more differentiated products for clients on both the investment and the investor side.

Until recently, investors have accessed litigation funding through hedge funds (Webb, 2011). Currently, however, new intermediaries, such as CrowdJustice, Burford Capital, and Juridica have started to provide direct access for institutional and private investors. These firms have expanded crowdfunding in litigation finance beyond commercial matters in civil cases and tort claims. For example, in 2016 CrowdJustice, a UK platform, crowdfunded a case concerning the rights of Parliament in the withdrawal of the United Kingdom from the European Union (Brexit). The case went all the way to the UK Supreme Court, which ruled against the government, stating that only the UK Parliament could approve the decision to leave the EU (Munford, 2017).

Although litigation finance is still a very unconventional method of lawsuit funding (Rowles-Davies, 2016), there is evidence that exposure on the investor side has been increasing (Thompson, 2018; Volsky, 2013). While “there is no reliable measure of the overall size of the litigation finance market,” Barrett (2017), Burford Capital alone has more than $2 billion invested or available for spending. Similarly, the *Financial Times* reports “an ‘exploding’ demand for litigation finance in 2018” (Thompson, 2018).

Finally, it should be noted that crowdfunded litigation also raises legal issues. Most crowdfunded litigation is financed in countries that have a system of common law, such as Australia, the United Kingdom, and the United States, for most civil law jurisdictions prohibit litigation finance (Volsky, 2013). Even in countries that allow litigation finance, the novelty of crowdfunding still raises issues. For example, a crowdfunded legal case on Brexit brought in Ireland, which at the time of writing is still pending, questioned whether crowdfunded litigation violates Irish laws against maintenance and champerty, doctrines in common law that seek to disqualify frivolous litigation (Kavanagh, 2017). With many jurisdictions becoming increasingly open to litigation finance, however, the industry appears to be poised for growth worldwide (Robertson, 2011; Volsky, 2013).

## [H2] Litigation finance as an alternative investment

Litigation cases have been described as uncorrelated assets (Lex, 2017). For example, an analysis of the settlement data by a litigation company in Australia shows a correlation coefficient of only 0.01 with the benchmark S&P/ASK 200 index (Volsky, 2013). The fact that absolute returns are
“uncorrelated to traditional assets like equities, fixed income, foreign exchange, and commodities” (Volsky, 2013, p. 237) makes legal finance an option for those concerned with portfolio diversification and long-term wealth appreciation.

Currently, legal finance has three main product lines: Lawsuit advances for tort claims, funding for commercial matters, and loan products (Volsky, 2013). Tort claims seek approbation for damages that incur because of negligence, accidents, or personal injury (LexShares, 2016). The most common breach of contracts, commercial matters cover “areas such as intellectual property, antitrust, real estate, banking, securities, insurance, employment discrimination, and tortious interference” (LexShares, 2016, p. 2), while loan products are tailored to help attorneys and law firms finance case costs and overhead costs (Volsky, 2013).

Litigation finance providers claim that the return on investment of litigation finance is higher than almost any other asset class, and is higher than the average alternative asset (BlackRock, 2017). Performance data promises an internal rate of returns as high as 85% (Juridica, 2012), and returns on investment of about 70%, with an average gross return as high as 310% (Volsky, 2013).

# [H1] The attributes of alternative assets

Litigation finance is “not part of traditional asset classes such as cash, stocks, or bonds that retail investors are most familiar with” (World Economic Forum, 2015, p. 2) and represents a different approach to “investing across a variety of markets and vehicles assets” (BlackRock, 2017, p. 2); consequently, litigation finance may be defined as an alternative asset.

Although no two financial institutions define alternative investments in the same way (Chorafas, 2003), previous research has identified certain recurrent attributes of alternative assets (see **Exhibit 2**).

[PRODUCTION: Set Exhibit 2 about here]

## [H2] Different performance characteristics

Several researchers indicate that alternative investments have little correlation with traditional asset classes and a weak relationship with the macro environment, and also tend to be long-term in nature (World Economic Forum, 2015). In addition, most alternative assets prove to have low systematic risks (Grable & Chen, 2015) and provide a hedge against expected and unanticipated inflation (Kitces, 2012; Mosiondz, 2014). Many alternative assets also benefit from market volatility, regardless of the direction of the market trend.

## [H2] Different risk-return relationships

Alternative assets have “some risk characteristics that are additional to, and different from, traditional listed investments” (Skully, 2007, p. 37). They are costlier than traditional assets overall, but their long-term nature allows for long-duration liabilities and higher yields. Each alternative asset has risks, which are related to its framework. **Exhibit 3** lists the risks associated with alternative assets.

[PRODUCTION: Set Exhibit 3 about here]

Models for evaluating asset performance, adjusting for the measure of risk, include the Sharpe ratio: The higher the ratio, the higher the return, the lower the volatility, and the better the portfolio’s risk-adjusted performance (Sharpe, 1966). Sharpe ratios above 1 are considered to be good, ratios above 2 are very good, and ratios above 3 are exceptional (Thorp, 2013). LexShares promises calculated Sharp ratios of 7 or above.

## [H2] Market inefficiencies

Since alternative assets are so complex, they display higher inefficiencies and are less transparent than traditional assets. When information is not readily available, or is time-consuming, expensive, and difficult to accumulate, inefficiencies arise (Anson, 2003). These inefficiencies can take the form of irregular cash flows, transparency concerns, and cost valuation issues (Pesando & Shum, 2007).

## [H2] Illiquid or non-existent secondary markets

Many alternative assets, such as private equity, are not publicly traded (Anson, 2003), and liquidating an investment can involve long lead times. Fragmented or non-existent secondary markets lead to less frequent and, sometimes, unreliable asset valuation because the products are complex and the valuation processes are usually not automated (Simpson, 2016). Investors can benefit from illiquid markets and inaccurate valuation (Kaiser, 2005) by “exploiting the information asymmetries that can occur in private markets, and taking advantage of disparate pricing across markets that are segmented due to illiquidity or other pricing frictions” (Warren, 2014, p. 17).

## [H2] Need for specialized skills

Substantial investor relationships, exclusivity, and highly specialized professionals are essential to alternative assets (Joskow, 1987). Thus, alternative investments have traditionally only been used by institutional investors and individuals with a high net worth. Because they lack the elevated level of expertise needed to achieve superior returns in such markets, these investors operate through various intermediaries, limited partnerships, limited liability companies, and special-purpose vehicles (Andonov, 2014). The financial intermediaries involved obtain high rates of return by capitalizing on their informational and professional advantage (Admati & Pfleiderer, 1994).

## [H2] Tax benefits

Investors can achieve tax benefits by investing in alternative assets. This is because of the investments’ long holding periods and private capital commitments.

# [H1] Crowdfunding models

Crowdfunding has been described as an open call, essentially through the internet, for the provision of financial resources either in the form of donations (without rewards) or in exchange for some form of reward and/or voting rights in order to support initiatives for specific purposes (Lambert & Schwienbacher, 2012). Although crowdfunding in litigation finance is a relatively new idea, it shares some similarities with crowdfunding for startups, as both offer a standardized financial contract to “the crowd” (Hornuf & Schwienbacher, 2015).

**Exhibit 4** presents four crowdfunding models: donation-based funding, reward-based funding, peer-to-peer lending, and equity crowdfunding. These have been divided into two categories. In community crowd funding, the crowdfunder funds without any expected return (donation-based crowdfunding), or expects a gift or an exclusive right of a product or service offered (reward-based crowdfunding). In financial return crowdfunding, the investors purchase a stake (equity-based models) or lend money to get a financial return for the investment (peer-to-peer lending models).

Cumming, Leboeuf, & Schwienbacher (2015) further break down reward-based crowdfunding into two subcategories. The first is a “Keep-It-All” model that “involves the entrepreneurial firm setting a fundraising goal and keeping the entire amount raised, regardless of whether or not they meet their goal, thereby allocating the risk to the crowd when an underfunded project goes ahead” (Cumming et al., 2015, p. 2). The second is an “All-or-Nothing” model that “involves the entrepreneurial firm setting a fundraising goal and not keeping anything unless the goal is achieved, thereby shifting the risk to the entrepreneur” (Cumming et al., 2015, p. 2). Kickstarter and Indiegogo are prominent examples of reward-based crowdfunding models.

[PRODUCTION: Set Exhibit 4 about here]

# [H1] Litigation Finance and Crowdfunding

Litigation financing can be carried out through general crowdfunding platforms, specialized litigation crowdfunding platforms, and traditional business or personal websites (Perry, 2017). LexShares belongs to the category of specialized litigation crowdfunding platforms. The cohort of contributors for such platforms is “large, diverse, and case-specific, and each has a minor stake in the outcome” (Perry, 2017, p. 34). The litigation crowdfunding providers perform “the screening functions that are carried out by the funder in ordinary third-party funding” (Perry, 2017, p. 35), resulting in a selection of sufficiently strong claims.

Because the business model for litigation crowdfunding is novel, there is still significant room for exploring new variants (Fisher, 2016). Compared to traditional commercial third-party funding, crowdfunding for litigation finance can also :

* extend (beyond process costs) to outcome costs, most notably civil liability;
* be offered to claimants who seek non-monetary remedies, such as an injunction or a declaratory judgment; and
* offer defendants financing that usually had been provided only to claimants by collateralizating a loan (Perry, 2017).

## [H2] Stakeholders in litigation crowdfunding

The intermediaries typically involved in crowdfunding for business ventures are presented in Exhibit 5. Crowdfunding for litigation finance easily fits into this framework. LexShares’ platform acts as the intermediary crowdfunding platform, with the fund-seekers and capital providers on both sides. Banks are (still) included, as litigation finance providers need a license to sell securities. LexShares has outsourced this service to Wealthforge, which acts as a financial intermediary.

[PRODUCTION: Set Exhibit 5 about here]

## [H2] Crowdfunding platforms for litigation financing

Since LexShares was established in 2014, the popularity of crowdfunding platforms in litigation finance has grown, with companies such as CrowdJustice and FundedJustice in the United Kingdom using a similar business model (Graham, 2015; Rozenberg, 2015). Other intermediaries, such as CrowdLaw, Mighty Group, Inc., and Vinson Litigation Finance, which can be classified as “law bankers” (LexShares, 2016), have also entered the market in recent years.

The growth of crowdfunding platforms is mainly due to shifts in the litigation sphere, such as the decline in the use of laws against maintenance and champerty, skyrocketing litigation costs, and, in the United States, the prohibition against charging attorneys’ living expenses to their clients (Rodak, 2006). In an interview for Xcomony, the Boston-based media firm, Jay Greenberg explained, “over the past two decades, for commercial litigation finance, the regulatory environment has become more lenient” (Ruth, 2014). He also has said, however, that, “investors still don’t know that you can invest in legal claims in the US and the clients don’t really understand how to go about up-teaming this type of financing even if they know it exists” (Lattemann & Alon, 2015).

# [H1] Litigation finance at LexShares

As noted previously, investing in litigation funds is not new for professional investors. LexShares’ unique selling proposition is that “It connects investors who may have been shut out of the market with litigants who have a meritorious case but don’t have access to the funds they need to move forward” (Krause, 2015, p. 32). According to Greenberg, dedicated litigation finance funders, such as public or private hedge funds, focus on cases of at least $3 million per lawsuit, and hedge funds often will seek to deploy $5 million in a single opportunity (Lattemann & Alon, 2015). LexShares’ crowdfunding model “has made it possible for litigants with relatively small corporate disputes, often between $100,000 and $1 million in value, to line up individual investors” (Krause, 2015, p. 32).

Greenberg gives an example of how a typical case might unfold: “Let's say we’ve funded this case for $100,000. At the end of the day, the plaintiff wins, and they [the defendants] are required to pay LexShares $200,000. LexShares gives the plaintiff $100,000 and $100,000 stays as profit. The investors would get $80,000, and 20% of the $100,000 would go to LexShares” (Lattemann & Alon, 2015).

The risk and return relationship of LexShares litigation cases is binary, meaning that, in Greenberg’s words, the lawsuit “is either a complete zero or a massive win.” LexShares sells cases on a non-recourse equity basis, so if the case is lost “the plaintiff does not owe LexShares or LexShares investors anything,” he explained. Greenberg also noted that if “investors take on that type of risk — where they could get zeroed it out in an individual transaction — they need to be compensated” and that LexShares has “a target between 50% and 75% returns, should the claim be successful” (Lattemann & Alon, 2015). This corresponds to the returns of venture capital, where an investment in a small company is risky, but has the potential to yield returns of 20% to 50%.

In September 2017, LexShares reported more than $16.3 million in investments spread across over 40 cases. The largest case generated a payout of $3,775,000 and the smallest, $85,000, with an average of $408,000 (BusinessWire, 2017). Of the 40 lawsuits, eight were settled in favor of the plaintiff, one was lost, and the rest are pending. LexShares’ median internal rate of return is about 1.7 times the input in a case, including fees and expenses. This equals an average profit of around 66% within the median time to settlement of around 15 months per case (BusinessWire, 2017). Created by averaging the results of several lawsuits listed on LexShares’ website, the model in **Exhibit 6** shows the expected gross return on an investment of $25,000.

[PRODUCTION: Set Exhibit 6 about here, beneath the heading below.]

**EXHIBIT 6** Expected gross return

**[Text resumes here.]**

## [H2] How the LexShares model works

The investment process consists of four stages: origination, underwriting, structuring, and funding. The origination stage starts with a vetting process that encompasses marketing activities, attorney referrals, and broker services. Next, underwriters conduct eligibility checks by using databases and consult with attorneys and legal experts to critically analyze investments and select desirable opportunities. In the structuring phase, investment agreements and budgets are outlined. After this, the funding of the transaction is settled. Post-transaction activities include payment monitoring, case compliance, or, in case of default, collection and dispute resolution.

Most trials are funded with contingency or modified contingency agreements. “We create a new holding company for each case we fund. That’s how we sell these individual private placements,” Greenberg explained (Lattemann & Alon, 2015). This holding company acts as an investment advisor, is registered as a legal entity with the state of New York, and picks, diversifies, and deploys considerable sums of institutional capital across a multitude of cases. Thus, institutional investors don’t have to pick and enter their own cases each time they wish to invest in situations that require small investments. The service has its price of course. As Greenberg explained, “You give a capital commitment for $5 million and instead of your carry [that is, the expected return] being 20% of the profit you earn, maybe we bump your carry down to 18%” (Lattemann & Alon, 2015). In other words, in this scenario LexShares manages the $5 million for the investors, for a commission of about 2%, and the investors earn a yield of 18%.

During the funding step, LexShares provides capital (collected from crowdfunding investors) to capital seekers in the form of “equity crowdfunding,” a term that Greenberg said he hates. “LexShares is not a registered broker-dealer itself. The company acquires the equity trading access, as well as security infrastructure from third-party providers online. Suppliers and demanders of capital can apply directly to the company’s website,” he said. “I think the key value that we add for the end investor is sourcing, originating, and structuring these [litigation] deals. The attorneys, plaintiffs, and buyers of litigation finance products reach LexShares through two channels: either personal connections or direct application through the online platform” (Lattemann & Alon, 2015).

The final component of the business model relates to LexShares’ use of third-party providers. Under Title II of the Jumpstart Our Business Startups (JOBS) Act, first passed by the US Congress in 2012, LexShares is compelled to provide third-party verification. “A pain point for us, from an operational perspective, is that in order to invest in a private placement, you have to be an accredited investor approved by the SEC [Securities and Exchange Commission]” said Greenberg (Lattemann & Alon, 2015). Since LexShares is not an accredited investor, all the company’s operational functions (infrastructure, legal, and security) are outsourced to Wealthforge, an SEC-approved third-party provider that also serves as a broker-dealer.

## [H2] Cost structure

LexShares’ operational costs consist of fixed costs, namely salaries, which account for approximately $15,000 a month, and variable costs, which amount to about $5,000 per case. The main variable costs are accounting costs (about $800 per case), the creation of the new holding company ($500 per case), and form filing (about $ 2,000 per case). If the plaintiff prevails, the variable costs are covered; if not, “we’re basically forced to swallow those $5,000 costs,” said Greenberg (Lattemann & Alon, 2015). How LexShares deals with these costs differentiates the organization from its competitors.

Other litigation funders charge investors a significant management fee up front, whereas LexShares indirectly charges the plaintiff by collecting a small share of the capital raised by LexShares. “We typically take an up-front commission of 5% to 10%,” said Greenberg (Lattemann & Alon, 2015). Therefore, if LexShares raises $100,000 for a plaintiff, LexShares will pass $95,000 to the plaintiff and keep $5,000 to offset its fixed costs.

## [H2] Vetting and underwriting

The activities that LexShares performs are vetting, underwriting, and selling of securities. The capital that the company collects is used to cover expert witness fees, discovery and research costs, and financing when the attorney has taken a case on full contingency.

From a liquidity standpoint, large institutional investors are of greater interest to LexShares than small investors. While the value of a single customer investment generates a profit of about $500 to $600 per case, institutional investors sign future term sheets that go “well into eight figures,” said Greenberg. Nevertheless, he noted, “We will make sure that, for all of these deals, there is an allocation for individuals” (Lattemann & Alon, 2015). This is because the LexShares brand and equity are built from both channels: capital that is generated by funding and closing deals, and a large user base of people willing to invest in legal claims.

With more than a decade of experience, Max Volsky leads LexShares’ vetting and underwriting process. According to Greenberg, Volsky has an “excellent track record”— specifically, “about a 90% win rate, which generates an average internal rate or return of 56%” (Lattemann & Alon, 2015). To assess the successfulness of a case and ensure accurate valuations, LexShares “employs a legal underwriting team to consider the prevailing law, potential damages, recent decisions in similar matters, attorneys’ track records, litigants’ backgrounds, and how the case has progressed so far” (Krause, 2015, p. 32). Furthermore, Greenberg ensures the funding of cases against defendants “only when LexShares has the assurance of the defendant’s ability to pay” (Lattemann & Alon, 2015).

## [H2] Company website and information disclosure

From an operational perspective, LexShares’ most important asset is its online website, which it uses to source lawsuits and sell underlying securities. Although there is no privileged information on the platform, investors are given access to such court materials as the original complaint, orders of the executive committee, and the settlement agreement in a “replenished form that is digestible for a person who is not an attorney,” said Greenberg (Lattemann & Alon, 2015). This level of access is not granted to those who do not invest.

Investors are presented with their collection of legal cases, including information on the plaintiff’s legal team and a cash-flow model that lays out the projected return on investment (see Exhibit 6). Following a precise description of the case (for instance, the parties involved, a summary of the plaintiff, the name of the judge and jurisdiction, the case type and stage, and description of the damages being sought), a timeline summarizes the main events (see **Exhibit 7)**. Each event is hyperlinked to the original pertinent legal documents.

[PRODUCTION: Set Exhibit 7 about here]

The website also allows individuals to apply for funding. When making their case visible to investors, fund seekers have two options. The standard option makes all the details of their case visible to registered LexShares investors. As Greenberg explains, however, “We do get some … plaintiffs and attorneys that are highly sensitive to letting other people know that they are raising capital for their case. They don’t want the other side to know; they don’t want the court to know. It could be a point of weakness.” Therefore, the second “by request only” option allows plaintiffs and attorneys to view only selected information about the fund seekers’ lawsuits — for example, “medium-size business owner suing S&P 500 company for intellectual property violations.” This option provides a greater degree of privacy and can help prevent the release of commercially sensitive information.

# [H1] Implications for investors and the market

At the intersection of FinTech, crowdsourcing, and crowdfunding, LexShares has created a unique business model that offers investment services in litigation finance to both private investors and institutions. Because of its novelty, the exact nature of the LexShares business model is difficult to categorize. While it clearly fits into Lambert and Schwienbacher’s (2012) definition of crowdfunding, for investors the binary nature of its investments places it in Cumming et al.’s (2015) “Keep-It-All” category. Although it parallels other internet-based crowdfunding platforms, such as Kickstarter, it differentiates itself through its rigorous selection process. For institutional investors, LexShares’ business model is an investment that “is not necessarily restricted to a particular product or service” (Hornuf & Schwienbacher, 2015, p. 2), making it a “crowd financing model” that enables investors to deploy capital across a plethora of cases at the same time, each with unique individual outcomes and rewards. Because of its payoff structure, LexShares’ business model also represents reward-based crowd financing (Chen, 2017) for capital providers. The impact of LexShares on investors and the growth of companies like it have important implications for the business sector.

## [H2] LexShares and investors

Should litigation finance be a financial product for the mass market, for investment professionals, or only for institutional investors? One could argue that nonprofessional investors who purchase investments for their retirement ought to avoid such an exotic market. One could equally argue that LexShares’ overall approach, risk structure, and risk-to-return ratio appears to be ideally suited to an individual, nonprofessional, investor. How should investors view LexShares?

LexShares’ products have all the characteristics of an alternative asset: a differentiated asset class, with uncorrelated returns and low liquidity. The company’s products have different characteristics than those of other forms of investment, with little correlation to market movements and a unique risk-return relationship (Leitner, Mansour, & Naylor, 2007). Success is binary.

Non-correlation and binary performance are highly unusual, even when compared to other alternative investment products (Grable & Chen, 2015; Kitces, 2012; Mosiondz, 2014). This does not mean that they entail no risk at all, however (Lex, 2017). For example, questions remain about Greenberg’s statistics. According to Greenberg, LexShares litigation cases have a Sharpe ratio of 7 or above, a level that is unheard of for almost any other form of investment. If this is, indeed, the case, then it is no surprise that LexShares is originating more case opportunities than its investor base can currently support (Lattemann & Alon, 2015). Why would investors not line up for a non-correlated asset with a 90% win rate and an 85% return on invested capital?

Another unusual feature of LexShares’ products is that they do not involve the possession of a physical asset or any underlying holdings. This frees the investor from buying or selling the asset at any given time, but does introduce other risks and constraints. Payoff is on contingency, and rewards are given to investors only after a case is completed. There is no secondary market, and no resale or trading of litigation cases. Once an asset (that is, a case) is purchased by the investor, it needs to be held until the case is legally settled (LexShares, n.d.).

In the cases that LexShares deals with, there are also concerns regarding information disclosure and transparency. The carryover of transaction costs inevitably reduces profitability, while the complexity of the underlying asset allows the company to structure its fees in a non-transparent manner. In addition, although an investor is given detailed information about the case, it is doubtful that a nonprofessional investor would be able to interpret that information in the same way as a specialist attorney would. This has the potential to lead to misunderstandings regarding the nature of the product they have purchased. Since accurate external valuation of cases is challenging, highly specialized skills are needed to source, originate, and structure litigation deals.

All these factors may make investors, and non-professional investors in particular, skeptical of Greenberg’s claims regarding LexShares. Yet, LexShares has a business model that has the potential to radically alter the existing market, and this may, indeed, support the achievement of what may at first seem to be impossible results.

## [H2] LexShares’ business model and the financial sector

Crowdfunding has moved on from the original concept of being an easy way to fund startups based on seemingly crazy ideas without having to take more traditional routes. Being a crowdfunding pioneer in litigation finance, which is still a niche industry, LexShares should be able to leverage its first-to-market advantage and forge robust, durable relationships with investors, lawyers, and plaintiffs. Given this position, LexShares has the potential to disrupt and dominate the litigation finance sector, just as Uber and Airbnb have done in transportation and hospitality, and not only in terms of legal claims, but also in related financial services.

LexShares is another small but significant example of a business model that threatens the whole of the traditional banking industry by disintermediation, that is, by essentially cutting out the middleman. Made possible by the internet and powerful online platforms, this type of business model is based on collaboration and peer-to-peer exchange, which is closely linked to the concept of the sharing economy. Banking functions, such as payment and money transfer, and trusted third-party services are now increasingly being taken over by such companies as WeChat and PayPal. Similarly, blockchain technologies now allow secure money transfers directly between payer and receiver. LexShares’ business model disintermediates the banking sector by directly linking those who need money (the plaintiffs) with those who have money (the investors), eliminating the need for brick-and-mortar institutions and hard currency. In this new environment, “…peer-to-peer exchange becomes increasingly prevalent, and the ‘crowd’ replaces the corporation at the center of capitalism” (Sundararajan, 2016, p. 2).

Business models such as LexShares may even have implications beyond banking and could lead to changes in the justice system itself as it provides plaintiffs with funding for their claims, and new opportunities to pursue their legal rights. Crowdfunding litigation as a concept has implications beyond the funding of civil commercial cases envisaged by LexShares. As already noted, the UK platform CrowdJustice successfully crowdfunded a politically significant case in the United Kingdom concerning Brexit.

Beyond the legal implications, some argue that the crowdfunding business model also has implications for society at large. These platforms do not “… just give people the tools to raise money for a specific case. It galvanizes and empowers communities, by allowing them to support and champion causes they care about and to play a real role in achieving concrete outcomes through the legal system. It provides greater access to and participation in legal cases through mechanisms and channels that people are already accessing, such as social media outlets” (Munford, 2017).

To conclude, LexShares offers an alternative financial investment product based on litigation funding, with no correlation to financial markets or to any public or institutional investments, by bringing together investors, plaintiffs, and lawyers. The company’s experiences illustrate how the introduction of a disruptive technology by a single firm can revamp the litigation finance sector. Meanwhile, new economic approaches, such as crowdsourcing, can be seen as part of a move toward a sharing economy based on directly linking the different stakeholders in a value creation chain. The LexShares business model clearly has the potential to transform its business sector. How many other business models based on the sharing economy and located in niche industries will do the same? Only time will tell.

# [H1] References

Admati, A. R., & Pfleiderer, P. (1994). Robust financial contracting and the role of venture capitalists. *The Journal of Finance*, *49*(2), 371-402.

Andonov, A. (2014, March 30). Delegated investment management in alternative assets. Retrieved September 6, 2018, from https://papers.ssrn.com/sol3/papers.cfm?abstract\_id=2458224.

Anson, M. (2003). Registered hedge funds: Retail investors enter the marketplace. *Journal of Financial Planning*, *16*(8), 62-71.

Barrett, P. (2017, May 30). The business of litigation finance is booming. *Bloomberg Businessweek*. Retrieved March 28, 2018, from https://www.bloomberg.com/news/articles/2017-05-30/the-business-of-litigation-finance-is-booming.

BlackRock. (2017, June 30). Alternative investments: Myths & misconceptions. Retrieved April 23, 2018, from https://www.blackrock.com/pt/literature/market-commentary/10-myths-surrounding-alternative-investments-commentary.pdf.

BusinessWire. (2017, September 7). LexShares launches its first marketplace fund, as litigation finance continues to grow. Retrieved April 5, 2018, from https://www.businesswire.com/news/home/20170907005523/en/LexShares-Launches-Marketplace-Fund-Litigation-Finance-Continues.

Chen, D. (2017, 13 March). What is crowdfinancing? Retrieved September 6, 2018, from http://info.kickfurther.com/what-is-crowdfinancing.

Chorafas, D. N. (2003). *Alternative investments and the mismanagement of risk*. New York: Palgrave.

Cumming, D. J., Leboeuf, G., & Schwienbacher, A. (2015, May 31). Crowdfunding models: Keep-it-all vs. All-or-nothing. Retrieved April 6, 2018, from http://leeds-faculty.colorado.edu/bhagat/CrowdfundingModels-KeppItAll-AllorNothing.pdf.

Fisher, D. (2016, January 20). The next great investment idea? Somebody else's lawsuit. *Forbes*. Retrieved September 6, 2018 from https://www.forbes.com/sites/danielfisher/2016/01/20/the-next-great-investment-idea-somebody-elses-lawsuit/.

Grable, J. E., & Chen, X. (2015). Collectible, investment, or both: Evaluating the attractiveness of collectible stamps. *Journal of Financial Service Professionals*, *69*(5), 78-87.

Graham, M. (2015, January 8). Funded justice aims to help people raise funds for legal fees. *Chicago Tribune*. Retrieved April 3, 2018 from http://www.chicagotribune.com/bluesky/originals/chi-funded-justicemichael-helfand-bsi-20150105-story.html.

Hornuf, L., & Schwienbacher, A. (2015). Funding dynamics in crowdinvesting. *Beiträge zur Jahrestagung des Vereins für Socialpolitik 2015*. Retrieved September 6, 2018, from https://www.econstor.eu/bitstream/10419/112969/1/VfS\_2015\_pid\_663.pdf.

Ibrahim, N., & Verliyantina. (2012). The model of crowdfunding to support small and micro businesses in Indonesia through a web-based platform. *Procedia Economics and Finance*, *4*, 390-397.

Joskow, P. L. (1987). Contract duration and relationship-specific investments: Empirical evidence from coal markets. *The American Economic Review*, 168-185.

Juridica. (2012, September 17). Juridica investments limited: Half year results for the six months ended 30 June 2012. Retrieved April 5, 2018, from http://otp.investis.com/clients/uk/juridica-investments/rns/regulatory-story.aspx?cid=319&newsid=269130.

Kaiser, R. W. (2005). Analyzing real estate portfolio returns. *The Journal of Portfolio Management*, *31*(5), 134-142.

Kavanagh, M. (2017, January 24). Crowdfunding the Irish Brexit challenge. Retrieved September 5, 2018, from <https://www.lkshields.ie/news-insights/publication/crowd-funding-the-irish-brexit-challenge>.

Kirby, A. E., & Worner, S. (2014). Crowd-funding: An infant industry growing fast. Staff Working Paper. *IOSCO Research Department*, 1-62.

Kitces, M. E. (2012). What makes something an alternative asset class, anyway? *Journal of Financial Planning*, *25*(9), 22-23.

Krause, J. (2015). Crowdfunding can be a great way to finance your case--or destroy it. *ABA Journal*, *101*, 32.

Lambert, T., & Schwienbacher, A. (2012). Crowdfunding of entrepreneurial ventures. In D. J. Cumming (Ed.), *The Oxford handbook of entrepreneurial finance* (pp. 369-391). New York: Oxford University Press.

Lattemann, C., & Alon, I. (2015, February 2). Skype interview with Jay Greenberg.

Leitner, C., Mansour, A., & Naylor, S. (2007, September). Alternative investments in perspective. *RREEF Research*. Retrieved March 23, 2018, from http://realestate.dws.com/content/\_media/Research\_Alternative\_Investments\_in\_Perspective\_September\_2007.pdf.

Lex. (2017, August 28). Burford capital: Class war capitalist. *Financial Times*. Retrieved March 24, 2018 from https://www.ft.com/content/cc46e274-54c6-11e7-9fed-c19e2700005f.

LexShares. (2016). An introduction to litigation finance. Retrieved March 05, 2018, from https://www.LexShares.com/Legal\_Finance\_Summary\_Volsky.pdf.

LexShares. (n.d.). LexShares - invest in legal claims. Retrieved March 06, 2018, from https://www.lexshares.com/invest.

Mosiondz, P. (2014). What’s it worth? *The American Stamp Dealer & Collector*, *81*(6), 60.

Munford, M. (2017, February 28). After disrupting Brexit, crowdfunding and crowdjustice come to the US. *Forbes*. Retrieved September 5, 2018 from https://www.forbes.com/sites/montymunford/2017/02/28/after-disrupting-brexit-crowdfunding-and-crowdjustice-come-to-the-us/.

Perry, R. (2017, September 1). Crowdfunding civil justice. Retrieved September 6, 2018, from https://papers.ssrn.com/sol3/papers.cfm?abstract\_id=3041129.

Pesando, J. E., & Shum, P. M. (2007). Investing in art: A cautionary tale. *The Journal of Wealth Management*, *9*(4), 80-87.

Robertson, C. B. (2011). The impact of third-party financing on transnational litigation. *Case Western Reserve Journal of International Law*, *44*, 159-181.

Rodak, M. (2006). It’s about time: A systems thinking analysis of the litigation finance industry and its effect on settlement. *University of Pennsylvania Law Review*, *155*, 503-535.

Rowles-Davies, N. (2016, January 18). The evolution of litigation finance. *Lawyer,* 30*,* pp. 28-31.

Rozenberg, J. (2015, May 25). Is crowdfunded litigation the future of justice? *The Guardian*. Retrieved September 6, 2018 from https://www.theguardian.com/commentisfree/2015/may/25/crowdfunded-litigation-future-justice-crowdjustice.

Ruth, J.-P. S. (2014, November 26). LexShares, out of stealth, brings crowdfunding to litigation financing. *Xconomy*. Retrieved September 6, 2018, from https://www.xconomy.com/new-york/2014/11/26/lexshares-out-of-stealth-brings-crowdfunding-to-litigation-financing/.

Sharpe, W. F. (1966). Mutual fund performance. *The Journal of Business*, *39*(1), 119-138.

Simpson, J. D. (2016). Performance analysis for alternative investment classes. *Journal of Performance Measurement*, *21*(1), 24-33.

Skully, M. (2007). Alternative investments: Definition, importance and risks. *JASSA*, *3*(Spring 2007), 35-39.

Sundararajan, A. (2016). *The sharing economy: The end of employment and the rise of crowd-based capitalism*. Cambridge, MA: MIT Press.

Thompson, B. (2018, March 14). Burford shares jump 28% on ‘exploding’ demand for litigation finance. *Financial Times*. Retrieved March 15, 2018 from https://www.ft.com/content/1260be8c-2768-11e8-b27e-cc62a39d57a0.

Thorp, W. A. (2013). Interpreting the Sharpe ratio. *American Association of Individual Investors*, (May, 2013). Retrieved April 4, 2018 from https://www.aaii.com/journal/article/2-interpreting-the-sharpe-ratio.touch.

United Nations Development Programme. (2017, June 12). Financing solutions for sustainable development. United Nations Development Programme. Retrieved September 6, 2018, from http://www.undp.org/content/dam/sdfinance/doc/Crowdfunding%20\_%20UNDP.pdf.

Van Voorhis, S. (2017, December 12). Litigation funders see big future in us construction. *ENR: Engineering News-Record,* pp. 10-11.

Volsky, M. (2013). *Investing in justice: An introduction to legal finance, lawsuit advances and litigation funding*. Maywood, N.J.: Legal Finance Journal.

Warren, G. (2014, October 23). Long-term investing: What determines investment horizon? CIFR Paper No. 39. Retrieved September 6, 2018, from https://papers.ssrn.com/sol3/papers.cfm?abstract\_id=2513088.

Webb, M. S. (2011, October 14). Is there a case for litigation funding? *Financial Times*. Retrieved March 26, 2018, from https://www.ft.com/content/1f8ed2a2-f5b4-11e0-be8c-00144feab49a.

World Economic Forum. (2015, July). Alternative investments 2020: An introduction to alternative investments. Retrieved March 20, 2018, from http://www3.weforum.org/docs/WEF\_Alternative\_Investments\_2020\_An\_Introduction\_to\_AI.pdf.

[H1] AUTHOR BIOGRAPHY

**Christoph Lattemann**, PhD, is a professor of business administration and information management at Jacobs University in Bremen, Germany, and adjunct professor of entrepreneurship at the University of Agder in Kristiansand, Norway. He earned his doctoral degree at the University of Bremen. Dr. Lattemann’s main research focuses on business informatics, innovation management, and international business. He has been a visiting scholar at Harvard University’s Kennedy School of Government and at Stanford University, has taught in leading international MBA programs and universities, and written ten books and more than 150 articles. He can be reached at c.lattemann@jacobs-university.de.

**Ilan Alon**, PhD, is a professor of strategy and international marketing at the School of Business and Law at the University of Agder in Kristiansand, Norway. He holds a doctoral degree from Kent State University (USA) and is a researcher in the field of international business with a focus on internationalization, modes of entry, political risk, cultural intelligence, and emerging markets. Head of international affairs for the School of Business and Law at the University of Agder and the leader of the Emerging Markets research group, Dr. Alon is also editor-in-chief of *International Journal of Emerging Markets* and *European Journal of International Management*. He can be reached at ilan.alon@uia.no.

**Emily Patig**, BA, studied global economics and management at Jacobs University in Bremen, Germany, and Fudan University, China. Having conducted part of the original research on LexShares, she is currently working in the finance industry. She can be reached at emikykissler4@gmail.com.