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SEMINAR

"Theory of optimal contracts in continuous-time models"

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Room 12 – Via Sarfatti 25 - 20136 Milano

Abstract:

This talk will give a survey of recent results in continuous-time contract theory. The general question is how a "principal" (a company, investors ...) should design a payoff for compensating an "agent" (an executive, a portfolio manager, ...) in order to induce the best possible performance. We will discuss the following frameworks:

(i) first best: the principal and the agent have same, full information;
(ii) second best: the principal cannot monitor agent's actions
(iii) third best: the principal does not know agent's type either
(iv) the time of payment may be random

We identify under which conditions it is optimal to pay with linear contracts (cash plus stock shares), in which it is optimal to pay by nonlinear contracts (such as options), and in which also a random benchmark value has to be used in compensation. We also consider how the possibility of the agent's hedging influences incentives.