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Rank Uncertainty in Organizations

Abstract:

A principal incentivizes a team of agents to work by privately offering them bonuses contingent on team success. We study the principal's optimal incentive scheme that implements work as a unique equilibrium. This scheme leverages rank uncertainty to address strategic uncertainty. Each agent is informed only of a ranking distribution and his own bonus, the latter making work dominant provided that higher-rank agents work. If agents are symmetric, their bonuses are identical. Thus, discriminatory incentives are strictly suboptimal, in sharp contrast with the case of public contracts (Winter, 2004). We discuss implications for pay transparency and discrimination in organizations.