

Hierarchical Structures and Dynamic Incentives

ABSTRACT:

We study an organization with limited commitment. In our model, the organization cannot make a long term commitment to the wage transfers and its output level, while it can commit to the hierarchical structure. According to our result, the optimal hierarchical structure is 'horizontal' when it is highly likely that the agents are efficient (or inefficient). However, when such likelihood is in the intermediate range, or output levels are not expanding very fast over time, the optimal structure is 'vertical'---with a vertical hierarchy, the organization can mitigate dynamic incentive problems linked to limited commitment.

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