Mechanism Design with Collusive Supervision: A Three-tier Agency Model with a Continuum of Types, including Applications to Organizational Design[◆]

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ABSTRACT

We apply the "Monotone Comparative Statics" method à la Topkis (1978), Edlin and Shannon (1998), and Milgrom and Segal (2002)'s generalized envelope theorem to the three-tier agency model with hidden information and collusion à la Tirole (1986, 1992), thereby providing a framework that can address the issues treated in the existing literature, e.g., Kofman and Lawarree (1993)'s auditing application, *in a much simpler fashion.* Using its tractable framework, we examine some interesting extensions, such as the effect of introducing another supervisor, the problem resulting from a lack of the principal's commitment, and the effect of incorporating behavioral elements into the model. In addition, we derive some clear and robust implications applicable to corporate governance reform, such as a choice between the companies with auditors vs. committees as a top management organization.

Key Words: Mechanism Design, Collusion, Supervision, Monotone Comparative Statics, Corporate Governance, Behavioral Economics

JEL Classification: D82, D86

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