Efficiency of incentives with Subjective Evaluations

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Abstract

This paper considers a model in which a principal motivates an agent to make efforts through an incentive with subjective information in a long-term relationship and characterizes optimal contracts. Moreover this paper compares them with contracts in the circumstance where objective information is available instead of subjective information. Consequently it is shown that there is a situation where the principal's expected cost for inducing efforts is less under the optimal contracts with subjective evaluation than any contract with objective information. Finally this paper examines implications for managerial practice through these results.

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