Centralisation vs. Delegation: A Principal-Agent Analysis

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Abstract

We use a principal-agent framework to compare two types of organisational structures, centralisation and delegation. Moreover, we do so in a framework that allows for collusive possibilities among the agents. Under a centralised structure the principal directly contracts with all agents, whereas under delegation the principal contracts with only a few of the agents, giving them the right to enter into contracts with other agents. Delegated contracts are quite common in production networks, supply-chain-management and procurement. The broad aim of this paper is to explore conditions under which delegation outperforms centralisation. The modelling of collusion among agents is quite crucial in this literature. We develop an intuitive model for collusion, showing that collusion among agents may in fact be beneficial for the principal as well, so that the literature justifying delegation as a counter-strategy to collusion may be somewhat misplaced. We also explore the optimal form of delegation.