

„Only time will tell - A theory of deferred compensation”

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Abstract

We characterize optimal contract design in settings where the principal observes informative signals about the agent's initial action over time. Under bilateral risk-neutrality and agent limited liability, all relevant features of a signal process can be encoded in a single "informativeness" function of time. This function is increasing, implying that the contract can condition on more informative statistics over time, and, thus, fully captures the notion of "only time will tell." Optimal payout times trade off this benefit of deferral with the associated cost resulting from the agent's relative impatience. We show how the timing dimension of the compensation contract can be used to extract rents from the agent and fully characterize the equilibrium action choice. Our framework lends itself to evaluate the effects of recent regulatory proposals in the financial sector mandating the deferral of bonus payments and the use of clawback clauses.