

Embracing the Enemy

Álvaro Delgado-Vega Johannes Schneider

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Organizations as Communities of Fate



Our setting

Imagine an organization of a principal and an agent (the “Friend”).

Both have (conflicting) **ideas about the long-run direction** of the organization.

Now **a second agent** (the “Enemy”) enters. He has vastly different ideas than Friend, also disagrees with Principal.

Enemy and Friend now engage in a **repeated power struggle** for decision rights

Sometimes the struggle is decided exogenously, sometimes Principal chooses.

How can Principal use her (limited) influence optimally?

Model

3 players: 1 Principal P , 2 agents L and R

Discrete time, perfect information, ∞ -horizon, discount factor $\beta \in (0, 1)$.

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Stage Game:

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2. with probability $p(s_t) = 1/2 + s_t$, agent R is selected, otherwise L is selected,
3. the selected agent k chooses today's action $y_t \in [0, 1]$,
4. payoffs realize.

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Each player has an ideal action,

$$\theta_L \equiv 0, \quad \theta_R \equiv 1, \quad \theta_P \equiv \theta \in [0, 1/2)$$

Flow payoffs: $u_{i,t} = -|\theta_i - y_t| + \mathbf{1}_i b$

where $\mathbf{1}_i = 1$ iff i is selected, $b > 0$.

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Special Case 1: $\theta = 0$ & Commitment

Assume $\theta = 0 \Rightarrow P$ and L are fully aligned.

The optimal contract has 2 stages:

1. try to **exclude** R from decision-making rights as long as possible, $s^0 = -m$.
2. fully **embrace** R , after he leads for the first time, $s^* = m$.

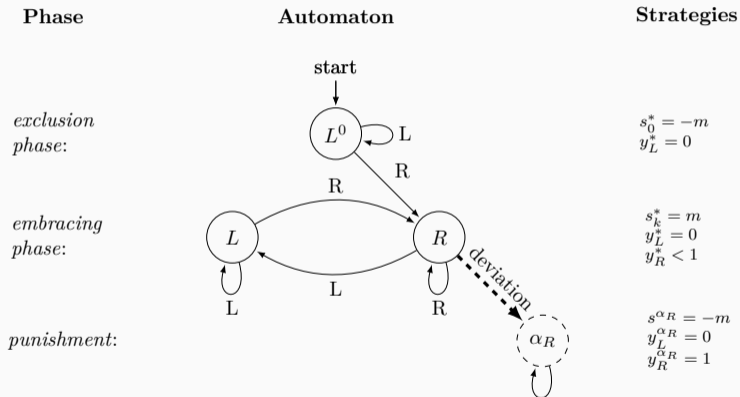
Proposition

The optimal contract switches from the exclusion to the embracing phase when R is selected for the first time. Agents choose the following actions,

$$y_R^* = \max \left\{ 1 - \frac{2\beta m(b+1)}{1 - \beta(1/2 - m)}, 0 \right\} < 1,$$

$$y_L^* = 0.$$

Optimal Contract: Automaton



Embracing the Enemy: Intuition

Agents want to lead for two reasons: **holding power** and **using power** for policy.

Principal's endorsement gives them both at once.

By requesting moderation in exchange for power, P pays

- R by allowing her to hold power
- L by allowing for better policy

Principal only cares about policy

- ⇒ her exchange rate power/policy is smaller than that of R .
- ⇒ she is willing to trade all her b .

Special Case 2: No Commitment

Proposition

P 's commitment plays no role iff

$$b \geq \bar{b}_0 := \frac{(1 - \beta)^2}{\beta(2 - \beta(1 + 1/2 - m))(1/2 + m)}.$$

If $b < \bar{b}_0$, we can only repeat static Nash.

Why bang/bang? Intuition

If b is large $\rightarrow R$ is willing to moderate enough for P to be happy.

But what if b is small?

Start at the static Nash ($s = -m$). Assume we increase R 's endorsement, s

Two effects

Marginal effect: increase R 's
chances \Rightarrow bad for P

Inframarginal effect: increase R 's
concession \Rightarrow good for P

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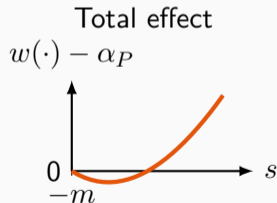
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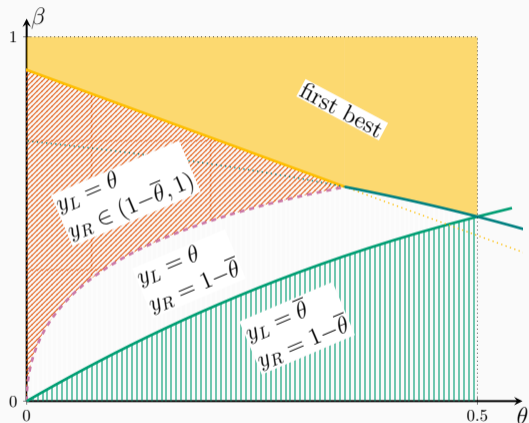
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Inframarginal effect: increase R 's concession \Rightarrow good for P



If second root within domain
 \Rightarrow commitment implementable

The General Case: Commitment



Shades represent Embracing Strategies



- Exclusion phase remains
- Whenever R is in the lead \Rightarrow fully endorse R
- Whenever L is in the lead \Rightarrow depends.

1. Radical Newcomers
 - At first: *cordon sanitaire*
 - Eventually: cordon sanitaire breaks
 - Then: embrace the enemy
2. P centrism reduces polarization
3. A non-extreme P prefers to have R over a dictatorship by L
4. Moderately biased P s perform best

The No Commitment Case

2 Problems: Keep promises, and threaten to punish

3 Results:

Centrism is Commitment: If θ close to $1/2$, commitment contract implementable

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Gradual unraveling: 3 thresholds (for θ large but not too large)

\bar{b} : Above commitment solution implementable

\hat{b} : On (\hat{b}, \bar{b}) contract qualitatively similar to commitment, but L concedes less.

(P cannot punish effectively)

\check{b} : On (\check{b}, \hat{b}) , never fully endorse R even after lead (P 's constraint binds on-path)

below: static Nash

⇒ Not a bang-bang outcome!

Wrapping Up

- a model of dynamic power struggle and optimal power brokerage
- two stage contracts: **cordons sanitaires** → **embracing the enemy**
- better to have an enemy than dictatorship of a friend
- moderately biased principal best off

Role of Principal Commitment

- for extreme principal crucial (bang/bang)
- for more balanced principal less important (gradual unraveling)
- generally: power-driven agents help.