

Seminar V

Problem 1

Review Problem 6, parts (i) and (ii), in Tirole, p. 629.

Problem 2

- (i) Exercise 8.1 in Tirole, p. 353.
- (ii) Compare with the analysis in Sec. 8.2.2 in Tirole, pp. 340-341.

Problem 3. (Exam fall 2010)

Set up a simple, fixed-investment model of investor activism under conditions of moral hazard, where a monitor incurs a cost c of monitoring, and where the monitor's presence brings down the entrepreneur's private value of misbehaving from B to b , with $B > b > 0$.

- a. Suppose first that monitoring capital is abundant and discuss how the presence of a monitor may facilitate a firm's funding.
- b. Suppose next that monitoring capital is scarce and discuss how such scarcity of monitoring capital may make a firm's funding more difficult.

(Note: At the exam, this problem counted 35%, which is about 1 hour in a 3-hour exam.)