

# Example: Real Estate Agents and Home Sellers

The principal-agent problem (or agency dilemma) arises when one person (the "agent") is allowed to make decisions on behalf of another person (the "principal"), but their interests may not necessarily align.

**Scenario:** Imagine you want to sell your house, and you hire a real estate agent to represent you in the sale.

**Principal:** You, the homeowner.

**Agent:** Real estate agent.

## Interests:

- **Your interest** (as the principal) is to sell your house for the highest price possible.
- **The real estate agent's interest** (as the agent) might be to sell the house as quickly as possible.

**Problem:** Suppose your house could be sold for \$300,000 if you wait for a couple of months, or \$280,000 if sold within a week. Selling for the higher price would net you an additional \$20,000 (less a small increase in the agent's commission).

However, from the agent's perspective, waiting might only increase their commission by a small amount, say \$500 (if we assume a 2.5% commission rate). They might prefer to make a quick sale, get the commission earlier, and move on to other clients. Hence, the agent might not be as motivated to wait for a higher offer, whereas you, as the homeowner, might prefer to wait for the potential of an extra \$20,000.

**Solution:** To mitigate the principal-agent problem, contracts can be designed to better align the interests of the principal and agent. For instance, a homeowner could offer a bonus to the agent if the house sells above a certain price threshold, or the commission structure could be progressive based on the sale price.