

# SUPPLEMENTARY MATERIALS FOR “RETROSPECTIVE SEARCH: EXPLORATION AND AMBITION ON UNCHARTED TERRAIN”

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**Abstract.** These supplementary materials expand on the main text in several directions. First, in Section 1, we provide an analysis of retrospective search by a risk-averse agent. Second, in Section 2, we discuss retrospective search absent flow costs. Last, in Section 3, we study commission contracts for agents searching over independent observations.

## 1 Beyond Risk Neutrality

In this section, we provide techniques for deriving the optimal policy for retrospective search when agents are risk averse. For simplicity, we assume here that there is no discounting,  $r = 0$ . The analysis of the optimal search scope follows that described in the main text. We focus here on the derivation of the optimal stopping boundary. As a special case, we illustrate the optimal stopping boundary for agents with constant relative risk aversion (CRRA) utilities.

We start by providing an alternative representation to that offered by Lemma A2 (absent discounting) in the appendix to the paper. We then deliver an alternative characterization of the stopping boundary.

**Claim 1:** *Let  $w(\cdot)$  be the solution of the following Abel equation of the second kind:*

$$w(M)w'(M) - w(M) = \frac{(\sigma^0)^2}{2c(\sigma^0)}u'(M). \quad (1)$$

*The optimal stopping boundary is given by:*

$$g(M) = M - H'(M)\frac{(\sigma^0)^2}{2c(\sigma^0)},$$

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where  $\frac{4c}{\sigma^2}w(M) = 2\sqrt{\frac{4c}{\sigma^2}(H(M) - u(M))}$ .

**Proof of Claim 1:** We first identify an equivalent ordinary differential equation (ODE) for the stopping boundary. The relationship of this ODE, which was originally derived for calculating the value of a stopping problem for a standard Brownian motion with fixed flow costs, and the one in [Peskir \(1998\)](#) was noted by [Obłój \(2007\)](#). We adapt the ODE to our setting, allowing for search scope and its associated cost.

**Lemma SM1** *Let  $H(M)$  be defined as the minimal solution that satisfies  $H(M) \geq u(M)$  to the differential equation*

$$H(M) - \frac{(\sigma^0)^2}{4c(\sigma^0)}(H'(M))^2 = u(M). \quad (2)$$

Then,

$$g(M) = M - H'(M) \frac{(\sigma^0)^2}{2c(\sigma^0)}.$$

**Proof of Lemma SM1:** When  $r = 0$ , after some algebraic manipulations, equation (9) in Lemma A2 reduces to

$$g'(M) = \frac{u'(M)(\sigma^0)^2}{2c(\sigma^0)(M - g(M))}.$$

Thus, the optimal stopping boundary is the maximal solution  $g(M) \leq M$  of the above ODE. We now verify that the specification in the lemma's claim indeed satisfies this ODE.

From the first equality, equation (2), analysis identical to that of [Obłój \(2007\)](#) illustrates that the minimal solution satisfying  $H(M) \geq u(M)$  corresponds to  $H'(M)$  being chosen as the positive square root as follows:

$$\begin{aligned} H'(M) &= \sqrt{\frac{4c(\sigma^0)}{(\sigma^0)^2}(H(M) - u(M))} \\ \implies H''(M) &= \frac{\frac{4c(\sigma^0)}{(\sigma^0)^2}(H'(M) - u'(M))}{2\sqrt{\frac{4c(\sigma^0)}{(\sigma^0)^2}(H(M) - u(M))}} \\ \iff H''(M) &= \frac{\frac{2c(\sigma^0)}{(\sigma^0)^2}(H'(M) - u'(M))}{H'(M)} \\ \iff H''(M) &= \frac{2c(\sigma^0)}{(\sigma^0)^2} \left(1 - \frac{u'(M)}{H'(M)}\right). \end{aligned}$$

Consider the equation for  $g(M)$  in the lemma's claim. It implies that:

$$H'(M) = \frac{(M - g(M))2c(\sigma^0)}{(\sigma^0)^2} \text{ and}$$

$$g'(M) = 1 - \frac{H''(M)(\sigma^0)^2}{2c(\sigma^0)}.$$

Plugging in  $H'(M)$  in  $H''(M)$  derived above and then plugging  $H''(M)$  in the expression for  $g'(M)$ , we have

$$g'(M) = 1 - \frac{H''(M)(\sigma^0)^2}{2c(\sigma^0)}$$

$$\iff g'(M) = \frac{u'(M)}{H'(M)}$$

$$\iff g'(M) = \frac{u'(M)(\sigma^0)^2}{2c(\sigma^0)(M - g(M))}.$$

Our choice of  $H(M)$  as the minimal solution further guarantees that  $g(M)$  as specified in the lemma is the maximal solution of this last ODE satisfying  $g(M) \leq M$ .<sup>1</sup> Thus, we reach our original ODE formulation, which completes the lemma's proof.

Going back to the proof of Claim 1, let  $H(M)$  be defined by Lemma A1. As noted by [Zaitsev and Polyanin \(2002\)](#), introducing the transformation  $\frac{4c(\sigma^0)}{(\sigma^0)^2}w = 2\sqrt{\frac{4c(\sigma^0)}{(\sigma^0)^2}(H - u)}$ , equation (2) transforms into an *Abel equation of the second kind* in  $w$ ,

$$ww' - w = \frac{(\sigma^0)^2}{2c(\sigma^0)}u'(M).$$

This, together with Lemma SM1, completes the proof of Claim 1. ■

We now utilize the formulation offered by Claim 1 to offer methods for solving the optimal stopping boundary for non-linear utilities. As a special case, we apply these techniques to identify a closed-form solution for the optimal stopping boundary corresponding to CRRA utilities.

Consider the function  $H(M)$  identified in Lemma SM1. We can introduce the substitution  $y(M) = \frac{1}{w(M)}$  in the formulation (1) of Claim 1, which yields an *Abel equation of the*

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<sup>1</sup>Indeed, notice that our selection of  $H'(M)$  implies that

$$H'(M) = \sqrt{\frac{4c(\sigma^*)}{(\sigma^*)^2}(H(M) - u(M))}.$$

Thus,

$$g(M) = M - \frac{(\sigma^*)}{\sqrt{c(\sigma^*)}} \cdot \sqrt{(H(M) - u(M))},$$

which is decreasing in  $H(M) - u(M) \geq 0$ .

first kind:

$$y'(M) = -\frac{(\sigma^0)^2}{2c(\sigma^0)} (u'(M)) M^3 + (y(M))^2.$$

Consider now the transformation  $y(M) = -\frac{1}{tM'(t)}$  with  $t$  as a free variable. This yields an ODE of the *Emden-Fowler type*:

$$M''(t) = -t^{-2} \frac{(\sigma^0)^2}{2c(\sigma^0)} u'(M(t)). \quad (3)$$

This ODE is solved by [Panayotounakos and Zarmputis \(2011\)](#) and has the following parametrized solution, with  $z = z(t)$  as the free variable. For simplicity, we drop the explicit dependence of  $M(t)$  and  $z(t)$  on  $t$  to get:

$$\frac{\frac{(\sigma^0)^2}{2c(\sigma^0)} u'(M)}{M} = \frac{(3 + C_1 z) z^4}{\left[ (2 + C_1 z) \pm \sqrt{(2 + C_1 z)^2 - C_2 z^2} \right]^3},$$

where  $C_1$  and  $C_2$  are constants of integration that parametrize the solution, and  $z$  satisfies

$$t = t(z) = \frac{z}{(2 + C_1 z) \pm \sqrt{(2 + C_1 z)^2 - C_2 z^2}}. \quad (4)$$

From the above two equations we can conclude the following:

$$\frac{\frac{(\sigma^0)^2}{2c(\sigma^0)} u'(M)}{M} = (3z + C_1 z^2)(t(z))^3,$$

with  $z$  as a free parameter. Similarly, inverting equation (4), we get:

$$z(t) = \frac{4t}{C_2 t^2 - 2C_1 t + 1}.$$

In general, for any utility function, we can attempt getting a parametric solution using equations (3) and (4). However, the term  $\frac{\frac{(\sigma^0)^2}{2c(\sigma^0)} u'(M)}{M}$  suggests that some forms are easier to tackle compared to others. In particular, plugging in the CRRA form,  $u(M) = \frac{M^{1-\rho}}{1-\rho}$ ,

$$\begin{aligned} (M(t(z)))^{-\rho-1} &= \frac{2c(\sigma^0)}{(\sigma^0)^2} (3z + C_1 z^2)(t(z))^3 \\ \implies M(t(z)) &= \left[ \frac{2c(\sigma^0)}{(\sigma^0)^2} (3z + C_1 z^2)(t(z))^3 \right]^{\frac{1}{-\rho-1}}, \end{aligned}$$

which, inverting  $t$  and  $z$ , can be written as:

$$M(t) = \left[ \frac{2c(\sigma^0)}{(\sigma^0)^2} (3z(t) + C_1(z(t))^2)t^3 \right]^{-\frac{1}{\rho-1}}.$$

Let  $\frac{2c(\sigma^0)}{(\sigma^0)^2} (3z(t) + C_1(z(t))^2) = P(t)$ , so that

$$M(t) = \left[ P(t)t^3 \right]^{-\frac{1}{\rho-1}}.$$

Recall that

$$\begin{aligned} w(M(t)) &= -tM'(t) = M(t) \frac{1}{1+\rho} \frac{tP'(t) + 3P(t)}{P(t)} \\ &= M(t) \frac{1}{1+\rho} \left( \frac{tP'(t)}{P(t)} + 3 \right). \end{aligned}$$

Plugging in the functional form of  $z(t)$ , we have:

$$\begin{aligned} P(t) &= \frac{2c(\sigma^0)}{(\sigma^0)^2} \left[ \frac{16C_1t^2}{(C_2t^2 - 2C_1t + 1)^2} + \frac{12t}{C_2t^2 - 2C_1t + 1} \right], \\ P'(t) &= \frac{2c(\sigma^0)}{(\sigma^0)^2} \left[ -\frac{32C_1t^2(2C_2t - 2C_1)}{(C_2t^2 - 2C_1t + 1)^3} + \frac{32C_1t}{(C_2t^2 - 2C_1t + 1)^2} - \frac{12t(2C_2t - 2C_1)}{(C_2t^2 - 2C_1t + 1)^2} + \frac{12}{C_2t^2 - 2C_1t + 1} \right]. \end{aligned}$$

Since  $[w(M)]^2 = \frac{(\sigma^0)^2}{c} (H(M) - u(M))$ , we get:

$$\begin{aligned} H(M(t)) &= \frac{M(t)^{1-\rho}}{1-\rho} + \frac{c}{(\sigma^0)^2} \left[ M(t) \frac{1}{1+\rho} \left( \frac{tP'(t)}{P(t)} + 3 \right) \right]^2, \\ H(M(t)) &= \frac{M(t)^{1-\rho}}{1-\rho} + \frac{c}{(\sigma^0)^2} [w(M(t))]^2. \end{aligned}$$

Substituting  $P(t)$  into the expression for  $M(t)$  yields:

$$M(t) = \left( \frac{2c(\sigma^0)4t^4(3C_2t^2 - 2C_1t + 3)}{(\sigma^0)^2(C_2t^2 - 2C_1t + 1)^2} \right)^{-\frac{1}{\rho+1}}.$$

Taking the derivative with respect to  $t$  generates

$$H'(M)M'(t) = u'(M)M'(t) + \frac{c}{(\sigma^0)^2} [2w(M(t))w'(M(t))M'(t)].$$

By definition,

$$\frac{d[w(M(t))]}{dt} = w'(M)M'(t).$$

Recall that  $w(M(t)) = -tM'(t)$ . Thus,

$$w(M(t))w'(M) = -t \frac{d[w(M(t))]}{dt}.$$

Therefore, cancelling out  $M'(t)$  on both sides, we get:

$$H'(M) = u'(M) - \frac{c}{(\sigma^0)^2} \left[ 2t \frac{d[w(M(t))]}{dt} \right].$$

Recalling that  $-t^2 M''(t) = \frac{(\sigma^0)^2}{2c(\sigma^0)} u'(M(t))$  and  $w(M(t)) = -tM'(t)$ ,

$$H'(M) = -\frac{2c(\sigma^0)}{(\sigma^0)^2} w(M).$$

Now, observe that for the stopping boundary to be valid, we need  $u$  to be increasing over the domain of the process as otherwise we can potentially have  $u(X) > u(M)$ . For CRRA utilities, we know  $u$  is increasing over  $[0, \infty)$  so a natural restriction is to impose that the underlying process never reaches 0. This implies that the problem is only well defined whenever  $M_0 = X_0 > \underline{M} = \underline{X} > 0$  such that  $g(\underline{M}) = 0$ , which we identify below. The restriction that the boundary hits 0 at some  $\underline{M}$ , namely  $g(\underline{M}) = 0$ , is what allows us to identify the maximal solution of  $g(M) \leq M$  (as noted in [Obłój \(2007\)](#) for diffusions with bounded domain). This defines an additional boundary condition that needs to be satisfied by the ODE. That is,

$$g(\underline{M}) = \underline{M} - H'(\underline{M}) \frac{(\sigma^0)^2}{2c(\sigma^0)} = 0 \implies \underline{M} + w(\underline{M}) = 0.$$

Let  $\bar{M}$  be the minimal value of the observed maximum such that the agent stops searching whenever  $M \geq \bar{M}$ . If the agent never stops when reaching the observed maximal value, we let  $\bar{M} = \infty$ . The relevant domain of parameters  $t$  then corresponds to the set  $T$  such that for any  $M \in [\underline{M}, \bar{M}]$  there exists  $t \in T$  such that  $M(t) = M$ .

For some  $\underline{t} \in T$ , the level  $\underline{M}$  can be defined parametrically as

$$\underline{M} = M(\underline{t}) = \left( \frac{2c(\sigma^0)4\underline{t}(3C_2\underline{t} - 2C_1\underline{t} + 3)}{(\sigma^0)^2(C_2\underline{t} - 2C_1\underline{t} + 1)^2} \right)^{-\frac{1}{\rho+1}}.$$

Plugging this parametric identity into the boundary condition leads to

$$\begin{aligned} M(\underline{t}) &= -w(M(\underline{t})). \\ \implies M(\underline{t}) &= -M(\underline{t}) \frac{1}{1+\rho} \left( \frac{\underline{t}P'(\underline{t})}{P(\underline{t})} + 3 \right). \\ \implies -1 &= \frac{1}{1+\rho} \left( \frac{\underline{t}P'(\underline{t})}{P(\underline{t})} + 3 \right). \end{aligned}$$

Since  $H'(M) = -w(M)$  and  $g(M) = M - H'(M) \frac{(\sigma^0)^2}{2c(\sigma^0)}$ , for the stopping boundary  $g(M)$  to satisfy our requirement that  $g(M) \leq M$ , we must have that  $w(M(t)) \leq 0$  for all  $t \in T$  given the choice of  $C_1$  and  $C_2$ . This implies that, for all  $t \in T$ , we must have  $-w(M(t)) = tM'(t) \geq 0$ , and thus  $M'(t)$  has the same sign as  $t$  within  $T$ . Given our expression for  $M(t)$  above, it follows that, for any selection of  $C_1$  and  $C_2$ ,  $0 \notin T$ . In fact, our restriction that  $t$  and  $M'(t)$  coincide in signs implies that there exists  $\varepsilon > 0$  small enough such that  $(-\varepsilon, \varepsilon) \cap T = \emptyset$ . Similarly, for large enough  $\tilde{t} > 0$ , we have that  $(-\infty, -\tilde{t}) \cap T = \emptyset$  and  $(\tilde{t}, \infty) \cap T = \emptyset$ . From continuity, it follows that  $T = [\underline{t}, \bar{t}]$ , where  $M(\underline{t}) = \underline{M}$  and  $M(\bar{t}) = \bar{M}$ . From the definition of  $\bar{M}$ , it follows that  $g(\bar{M}) = \bar{M}$  so that  $H(M(\bar{t})) = u(M(\bar{t}))$ .

Recalling that  $H(M) = u(M) + \frac{c(\sigma^0)}{(\sigma^0)^2} w(M)^2$  implies  $w(M(\bar{t})) = 0$  as a second boundary condition, and thus

$$w(M(\bar{t})) = 0 = \left( \frac{\bar{t}P'(\bar{t})}{P(\bar{t})} + 3 \right).$$

Combining the ODE with its boundary conditions, we can pin down a parametric solution of  $C_1$ ,  $\underline{t}$ , and  $\bar{t}$  as a function of  $C_2$  and therefore an exact solution for the stopping boundary.<sup>2</sup> Qualitatively, the solution implies that  $\bar{M}$ , the level of the maximal observed value at which search ceases, is decreasing in the degree of risk aversion  $\rho$ . Intuitively, as the agent becomes more risk averse, the marginal returns from improving the current maximal value decline. Marginal search costs, however, are unchanged. Those costs then overwhelm search benefits at lower values of search outcomes.

## 2 Discounted Search Without Flow Costs

Suppose that search costs are derived from exponential discounting alone, with no flow costs. Formally, consider an agent facing a fixed search scope  $\sigma$  and maximizing an objective of the form  $e^{-rt}M_t$ , where  $r > 0$  is the agent's discount rate. Since  $\ln(\cdot)$  is strictly increasing, we can write the agent's optimization problem as:

$$\begin{aligned} \max_{\tau} \mathbf{E}(\ln M_{\tau} - r\tau) \\ dX_t = \sigma dB_t \\ M_t = \max_{0 \leq s \leq t} (X_s \vee M_0) \\ X_0 = M_0 = 0. \end{aligned}$$

This is equivalent to the optimization problem analyzed in the previous section taking the utility to be  $u(M) = \ln(M)$ , with constant search costs of  $r$ . As it turns out, there is

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<sup>2</sup>Relevant *Mathematica* code is available from the authors upon request.

a readily available parametrized solution to the ODE specified in equation (2) in Section 1.6.3.13 of [Zaitsev and Polyanin \(2002\)](#). Let

$$F = \left[ \int e^{\pm z^2} dz + C \right]^{-1}.$$

Then, the solution in parametric form is given by:

$$M(z) = \frac{\sigma}{\sqrt{c}} F e^{\pm z^2}$$

$$H(z) = \left[ (2z \pm F e^{\pm z^2})^2 \pm 4 \log\left(\frac{\sigma}{\sqrt{r}} F\right) - 4z^2 \right],$$

with  $\tau$  as a parameter and  $C$  as a constant of integration to be chosen. From Lemma SM1, one needs to find the minimal  $H(M) \geq u(M)$  that satisfies these equalities in order to obtain the closed-form solution for the optimal stopping boundary  $g(M)$ .

### 3 Contracting with Independent Draws

In this section we consider an analogue of section 5 of the main text with independent draws.<sup>3</sup> We consider a setting in which the agent is sampling from independent normal distributions centered around 0 and with a standard deviation  $\sigma$  chosen by the agent. The problem of the principal then takes a similar form to that described in the text. Setting  $X_0 = M_0 = 0$ , the principal's problem can be written as:

$$\max_{w, \alpha} \mathbf{E}((1 - \alpha)M_{\tau_{w, \alpha}} - \tau_{w, \alpha} w)$$

$$\text{s.t. } \tau_{w, \alpha} \in \arg \max_{\tau, \{\sigma_t\}_{t=0}^{\tau}} \mathbf{E}(\alpha M_{\tau} - \sum_0^{\tau} [c(\sigma_t) - w] dt),$$

where  $X_t \equiv N(0, \sigma_t)$  and  $M_t = \max_{0 \leq s \leq t} (X_s \vee M_0)$  as before. In order to solve the principal's problem, we first focus on the agent's problem. In contrast with the analysis in the main text, due to the stationary structure of the environment if the agent continues to search at some level  $M_t$ , they will continue to search at any lower level  $M'_t < M_t$ , thus they will use a sacrificing threshold, therefore the agent will never use recall. Given that the stopping rule is identified by a satisficing threshold ( $R$ ) we also know that the choice of  $\sigma_t$  will constant across time. Finally for any fixed level of  $\sigma$  by [Chow and Robbins \(1961\)](#) we know that one step look ahead policy is optimal and determines the threshold. In particular when the agent is exactly indifferent -at the threshold level- the value of sampling one more time

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<sup>3</sup>To our knowledge, the problem of delegating an infinite-horizon search problem has not been solved. [Zorc, Tsetlin, Hasija, and Chick \(2022\)](#) study a finite-horizon delegated search problem without recall and without a control. See other related work referenced there.



should be equal to the value of immediately stopping. Letting  $\phi^\sigma, \Phi^\sigma$  respectively denote the normal pdf and cdf respectively with variance  $\sigma^2$  we must have

$$\alpha R(\sigma, w, \alpha) = -c(\sigma) + w + \int_{R(\sigma, w, \alpha)}^{\infty} \alpha x \phi^\sigma(x) dx + \int_{-\infty}^{R(\sigma, w, \alpha)} \alpha (R(\sigma, w, \alpha)) \phi^\sigma(x) dx$$

Rearranging the terms we have

$$c(\sigma) - w = \alpha \left( \int_{t(\sigma, w, \alpha)}^{\infty} x \phi^\sigma(x) dx + t(\sigma, w, \alpha) (1 - \Phi^\sigma(t(\sigma, w, \alpha))) \right)$$

Letting  $\psi(t) = \phi^1(t) - t(1 - \Phi^1(t))$ , which is an invertible, positive and strictly decreasing function, by [Urgun and Yariv \(2021\)](#) we know that

$$R(\sigma, w, \alpha) = \psi^{-1}\left(\frac{c(\sigma) - w}{\alpha}\right)\sigma$$

which also corresponds to the value of the search to the agent. The agent therefore chooses  $\sigma$  to maximize  $R(\sigma, w, \alpha)$ . It follows that the optimal  $\sigma$  depends on both the flow wage  $w$  and the commission  $\alpha$ . It is far less amenable to analysis than the optimal agent speed resulting from correlated search.

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