# Lecture 15: Career Concerns

Compensation in Organizations

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# Roadmap

- In the first half of the class we discussed explicit performance pay.
- Last lecture we discussed one alternative: relational contracts.
- I work hard because I don't want to lose a good job.
- This lecture we consider another alternative: career concerns.
- I work hard at my current job to get a better future job at another company.

# Discussion: Fee and Hadlock (2003)

# Model

- There are two firms and one worker.
- The worker has a skill level $a$ that no one knows.
- However, everyone knows that skills are distributed uniformly between $[0, A]$. That is, $a \sim U[0, A]$
- The worker exerts unobserved, costly effort: $c(e) = e^2/2$
- Revenue is equal to effort plus skill: $y = e + a$
- The worker is hired and chooses effort in two periods.
- The worker is hired in each period by the firm that posts the highest wage, and if there is a tie they randomly pick a firm (the Bertrand model)
- All outside options are 0.

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- Taking the FOC wrt $e$:

$$e_{FB} = 1$$

## Diagram of the Model

See the board!

# Solving the Model

See the board!

# Solution

**Theorem 1**

*If uncertainty about skill is large enough ($A >> 0$), career concerns motivate the worker to provide first-best effort in the first period, $e_1^* = 1$.*

- The worker works hard to prove his/herself in period 1
- The worker reaps the reward for this in period 2
- The strength of career concerns depends on how uncertain the market is about a worker's skill.
- This is captured by $A$.

# Wages Over Time

- Skill ($a$) is initially unknown and everyone is paid the same wage: $A/2 + 1$
- Skill ($a$) is revealed when revenue realizes.
- Then each worker is paid their skill.
- This implies two things:
  - Wages of two workers become more dispersed over time
  - Wages may go up or down, with most going down.

# Effort Over Time

- Effort in the first period is high (the first-best level)
- Intuition: prove yourself when young, take it easy while old.

# Crucial Ingredients for Career Concerns

- There must be competition for the worker.
- Revenue in period 1 must be observed by everyone.
- Discussion: in what occupations is this true/not true?
- These are crucial because they allow the worker to internalize the benefits of effort/skill through higher wages in period 2.