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Large firms and within firm occupational reallocation

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Abstract

This paper considers the equilibrium interaction between within firm and across firm reallocation in the presence of labor market frictions. While a sizable literature has investigated frictional labor markets, it has ignored within firm mobility. Nonetheless, every year a sizable fraction of workers switch occupations without changing firms. Employees in large firms can sample from a larger selection and across firm mobility is replaced by within firm mobility. Bringing together within and across firm reallocation along with labor market frictions, naturally accounts for the observed differences in worker flows and wages across firms of different sizes.
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1. Introduction

A key role of labor markets is to assign workers to the task they perform best. A large literature investigates this assignment process in the presence of labor market frictions. This literature focuses on moves of workers across firms,[2] but ignores an important empirical phenomenon: every year 8% of workers switch occupations within their firm.[3] These moves within the firm allow workers to reallocate without being subject to labor market frictions and thus facilitate the assignment of workers to occupations. This paper considers how between and within firm mobility interact in the presence of labor market frictions.

In the first part of the paper, I examine empirically worker reallocation within and across firms, as well as the wage differences across firms of different sizes. Large firm workers switch occupations more often within their firm. In addition, they separate less often, even controlling for wages. Workers with high wages switch occupations less often within the firm and also separate from their firm less often. Within a firm, occupational flows are largely offsetting, so that for every worker going from one occupation to another, there is another worker switching in the opposite direction.

Moreover, I use matched employer–employee data from Denmark to gain further insights into the well-known firm size–wage premium, whereby workers in firms with more employees earn higher wages, including higher starter wages. I document that firms with more employees have more occupations. In addition, I find that controlling for the number of firm employees, workers in firms with more occupations have substantially higher earnings than workers in firms with fewer occupations.

Motivated by these findings, in the second part of the paper, I introduce an equilibrium model of within firm and across firm reallocation. The purpose of the model is to illustrate how in a frictional labor market, the greater selection of occupations in large firms can naturally account for the observed differences in worker flows and wages across firms of different sizes. With that goal in mind, the baseline model is tractable and, despite its simplicity, it can replicate analytically a number of labor market facts. At the same time it abstracts from other potentially important mechanisms such as ex ante worker and firm productivity heterogeneity, human capital accumulation and others.

In my baseline setup, a multi-worker firm constitutes a labor market without search frictions and workers can costlessly switch occupations within a firm. In contrast, reallocation across firms is subject to frictions. The quality of a match between a worker and an occupation is uncertain and revealed gradually. Workers and firms observe output realizations and update their beliefs in Bayesian fashion. At any point a worker has the option of leaving his current occupation and going to another one within his firm or to unemployment.

The optimal behavior of the worker is one of a reservation strategy: if his belief regarding the quality of his match with his current occupation falls below a certain threshold, the worker moves on to another one; this threshold is increasing in the number of occupations within the firm that the worker has not tried. Workers in large firms have more occupations remaining and are therefore willing to abandon unpromising matches more easily. In equilibrium, workers in large firms are better matched.

[2] Examples include Mortensen and Pissarides (1994), Burdett and Mortensen (1998), Postel-Vinay and Robin (2002) and Moscarini (2005).

[3] 1996 Panel of the Survey of Income and Program Participation.

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