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Chapter 16.2
Promotion practices

Outline

- Problem and model assumptions
- Task allocation after failure
- Task allocation after success
- Initial allocation of a low-risk task
- Initial allocation of a high-risk task
- Summary

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Hire and fire mentality

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- ▶ Expected salary: $\Pi_M^2 = \pi_2 w_{FS} + (1 - \pi_2) w_{FF} - C_2$

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Investment bank profits

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- ▶ Investment bank obtain the benefits V_i if successful
- ▶ Low risk task: $\Pi_B^{2L} = \pi_2 V_L$
- ▶ High risk task: $\Pi_B^{2H} = \pi_2 V_H$

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- ▶ Investment bank obtain the benefits V_i if **successful**, pays the **wages**
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- ▶ Investment bank obtain the benefits V_i if **successful**, pays the **wages**, and for the high-risk task loses **equity** if **not successful**
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- ▶ If failing in period 1, he is allocated the low-risk task, hence success or failure in period 1 would make no difference
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 - ▶ If failing in period 1, he is allocated the low-risk task, hence success or failure in period 1 would make no difference
 - ▶ The considerations in period 2 after failure apply and the employee is never allocated the high-risk task
- ⇒ Therefore, if **succeeding** in the high-risk task, the employee **stays** in this task

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- ▶ Which task has been allocated first is irrelevant for the incentives in the second time period
- ▶ If the task is **successful**, the employee will be allocated the **high-risk task**

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- ▶ If the task is successful, the employee will be allocated the high-risk task
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- ⇒ Employees **failing** in time period 1 will be allocated the **low-risk task** in time period 2

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Period 2 profits

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- ▶ If he **succeeds**, he will be allocated the high-risk task in period 2 and obtains those **profits**
- ▶ $\Pi_M^L = \pi_1 (\pi_2 w_{SS} + (1 - \pi_2) w_{SF} - C_2)$

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- ▶ If he **succeeds**, he will be allocated the high-risk task in period 2 and obtains those **profits**, less the **costs** of effort in period 1
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- ⇒ The low-risk task is **never allocated** in time period 1

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- ▶ $\frac{\partial C_1}{\partial \pi_1} = w_{SF} + \pi_2 \Delta w - C_2$

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- Problem and model assumptions
- Task allocation after failure
- Task allocation after success
- Initial allocation of a low-risk task
- Initial allocation of a high-risk task
- **Summary**

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