Job Referrals and Skills*†

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Abstract

We exploit a novel data set to study the extent to which firms rely on referrals when hiring for positions that require different levels of skill. The data come from the 2013-16 waves of a special supplement to the Survey of Consumer Expectations that focuses on job search behavior and outcomes. Using a measure of the skill content of different occupations that is widely used in the literature, we find that referrals are used most for low- and high-skill jobs, and less for intermediate-skill jobs. We develop a model that is consistent with these findings, in which referrals help firms to overcome two types of frictions: search frictions that make it difficult to find potential workers, and information frictions that make it difficult to identify the best worker from this set. According to our theory, the primary benefit of referrals for filling low-skill jobs is related to search frictions, while the primary benefit of referrals for filling high-skill jobs is related to information frictions. We explore the implications for inequality, and the differential effects of new technologies on hiring across skill levels.

Keywords: Labor Markets, Referrals, Networks, Search Theory, Asymmetric Information

JEL Classification: E42, E43, E44, E52, E58

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Extended Abstract

We exploit a novel data set to study the extent to which firms rely on referrals when hiring for positions that require different levels of skill. The data come from the 2013-16 waves of a special supplement to the Survey of Consumer Expectations that focuses on job search behavior and labor market outcomes.

Using a measure of the skill content of different occupations that is widely used in the literature, we find that referrals are used most frequently for hiring workers into low- and high-skill jobs, and less frequently for intermediate-skill jobs. Moreover, our data allow us to distinguish the source of the referral. We find that referrals from family and friends are used most frequently in the hiring process for low-skill jobs, and that these types of referrals are used less and less as the skill content of the occupation increases. We find the exact opposite pattern when we study the use of referrals from business contacts in the hiring process: these types of referrals are used more and more frequently as the skill content of the occupation increases.

Motivated by these empirical findings, we develop a theoretical model in which job referrals are used by firms to overcome two types of frictions: search frictions that make it difficult to find potential workers, and information frictions that make it difficult to identify the best worker from this set. According to our theory, the primary benefit of referrals for filling low-skill jobs is related to search frictions, while the primary benefit of referrals for filling high-skill jobs is related to information frictions. This is consistent with friends and family referrals being used primarily by low-skill jobs to reduce search frictions and business contacts being used to reduce information frictions for high-skill jobs.

We then use our model to examine the impact of referrals on hiring rates, wages, and job tenure. The model suggests that a referral that helped the worker-firm pair overcome search frictions has very different implications for labor market outcomes than a referral that helped the worker-firm pair overcome information frictions. We flesh out these implications, and use them to clarify the mixed evidence in the existing literature. Lastly, we explore the implications for inequality, and the differential effects of new technologies on hiring across skill levels. In particular, we discuss how online job sites, such as Monster and CareerBuilder, may substitute for referrals in reducing search frictions, and the impact this may have in reducing match quality and job tenure, particularly for low-skill jobs.