

## TRAINING EMPLOYEES: HOW FIRMS BENEFIT FROM INVESTING IN BOTH GENERAL AND SPECIFIC PROGRAMMES

Firms benefit from investing in a combination of general and specific training for their employees – say an MBA programme and an internal trainee programme. That is the central conclusion of new research by **Anke Kessler** and **Christoph Lulfesmann**, published in the October 2006 *Economic Journal*. Their study offers a solution to the longstanding question of why employers should invest in general skills for their staff when it seems that it will be the workers not the firm who reaps the rewards.

The question of why employers should spend their own resources training their workers in general-usage skills – the so-called Becker puzzle, named after the Nobel laureate – is one of the most studied issues in labour economics. The central idea is that general skills by definition raise workers' productivity with many other potential employers, and their market wage should therefore fully reflect any such productivity increases. Consequently, if workers are mobile across firms, they alone are the beneficiaries of general training, while employers cannot recover any of the cost.

Kessler and Lulfesmann's study offers a simple yet plausible solution to the Becker puzzle. Their starting point is that, realistically, employers can train not only in general skills, but also in firm-specific skills. From the firm's point of view, the latter will always at least partially pay off because, by definition, workers cannot transfer these skills to other firms (and hence, they are not reflected in the market wage).

The authors now show that both types of training are complementary from an employer's point of view: the presence of firm-specific skills will increase the incentive of employers to invest in general-usage skills, and vice versa.

The basic idea is best explained by an example. Suppose a firm hires a new employee and contemplates training her in general skills, say by sponsoring an MBA programme. This would raise her productivity by 20%, more than sufficient to cover the cost *a priori*.

If the new skills are truly general in nature, the employee's productivity goes up by the same amount when working with any other potential employer, and so would her external market wage. Her post-training wage inside the firm must then also go up by 20%; otherwise she'd quit. Thus, it is solely the employee, not the training firm, who benefits from such training.

Now suppose the employer instead decides that the employee should participate in an internal trainee programme. Because the skills thereby acquired are specific to the training firm, productivity with other employers remains largely unaffected. The employee's post-training wage if she stays will thus tend to be higher than the market wage she can expect if she quits.

As Kessler and Lulfesmann note, it is this gap between market wage and internal productivity created by firm-specific skills that make training in general skills profitable. Specifically, the firm may now be in a position to recoup its cost of general training as well. Even if the employee's market wage rises one-to-one with productivity (following her MBA degree), quitting may simply not be a viable option anymore because she already commands a wage in excess of what she can earn on the market.

As a result, her post-training wage need no longer reflect the additional productivity gain from general skills, making the employer a beneficiary of such investments as well. From the firm's point of view, providing the training in specific skills has made training in general-

usage skills profitable.

Interestingly, the authors show that the opposite is also true: the higher a worker's general usage skills, the more incentives the employer has to invest in firm-specific skills. This last result has important practical implications. For example, in countries like Germany where an institutionalised vocational training system facilitates investment in general-usage skills, the level of general training is often much higher than in countries like the United States, which lack such institutions.

Using the arguments of the study, a higher general skill level also implies that more specific training is taking place in Germany, which also reduces the level of labour turnover. Rather than being the result of inefficient labour market frictions, lower turnover rates could then be attributed the fact that German employers optimally provide better training in firm-specific skills, leading to fewer layoffs and quits.

ENDS

**Notes for editors:** 'The Theory of Human Capital Revisited: On the Interaction of General and Specific Training' by Anke Kessler and Christoph Lulfesmann is published in the October 2006 issue of the *Economic Journal*.

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