Preface

This book examines personnel economics within the context of the sport industry.

The field of personnel economics studies the intra-firm relationship between the employer and employee. It examines all aspects of the relationship, right from the initial hiring of the employee, through to the employee's eventual departure from the organization, and everything in between.

Lazear and Oyer (2012) identify the five primary aspects of the employment relationship that comprise the field of personnel economics: matching firms with workers (often known as recruiting and selection), incentives, compensation, skill development, and the organization of work. They note that, while personnel economics is a sub-field of labor economics, there are many topics in labor economics that are not part of personnel economics. Any topics that pertain to the overall market-wide interaction of firms and workers – for example, estimating an earnings function that shows the return to certain skills – are outside the choice set of a firm's managers, and are hence not within the realm of personnel economics. In personnel economics, the focus is on the firm, and how economics can be used to help managers make better personnel decisions.

In essence, personnel economics is a field that applies microeconomic theory to topics normally found within the human resource management (HRM) literature. Personnel economics differs from the HRM literature in that the former takes a 'rational actor' approach to the topic – from the economist's perspective, the traditional HRM literature suffers from the lack of an explicit and rigorous theory of human behavior, and hence is of limited value in consistently explaining and predicting organizational outcomes. In personnel economics, both employers and employees are assumed to be rational, self-interested, utility maximizers, whose interests are not always congruent. Much of the theory in personnel economics is rooted in such core themes as asymmetric information, the principal-agent relationship, monitoring, and optimal contract design.

The origins of personnel economics can be traced back to the early 1900s – a time when the fields of HRM and economics were rooted largely in the same foundations (Kaufman, 2000). By the 1930s, however, the two disciplines began to take very different intellectual paths, and it was not until the late 1980s that a reintegration began to occur – a reintegration driven almost exclusively by the seminal works of Stanford University economist Edward Lazear. Lazear's contributions are so extensive that he is often viewed as the single-handed founder of the modern field of personnel economics. In the 30 years that have passed since Lazear's earliest works in the area, the field of personnel economics has grown immensely, evidenced, in part, by the fact that it now has its own JEL code (M5).

Because of the field's focus on intra-organizational relationships, most researchers have been economists from business schools, rather than economics departments. Much of the research has been theoretical rather than empirical – largely due to data availability issues. Empirical work in the area requires researchers to have access to internal, firm-level data, and is thus dependent on firms voluntarily opening their personnel records. Further complications arise because detailed firm-level data on employees is, by its nature, proprietary and confidential, and is therefore not generally accessible for replication and verification by others. In his various writings, Lazear has often noted the difficulty in empirically testing theories within personnel economics (see, for example, Lazear, 1999).

This is where the professional sport industry plays a role. The employer-employee relationship in professional sport is much more visible and transparent than in almost any other industry. As a result, the researcher has information on a host of demographic variables pertaining to individual employees (i.e. players), such as their age, race, national origin, tenure with the organization, previous experience and training, etc. In addition, the researcher knows what each employee gets paid, who their co-workers (i.e. teammates) are, who their managers/coaches are, etc. Equally critically, the performance/productivity of pro athletes can be more objectively measured than in most other occupations. This array of data not only allows the researcher to test the relationship between critical personnel economics variables, like, say, pay and performance, but also enables the researcher to control for a wide range of other factors that may impact the relationship.

Not only can sports be a means to inform the personnel economics literature, the reverse is also true – the personnel economics literature can provide insight into better understanding the sport industry, which has become a focus unto itself for some economists. The field of sports economics has grown immensely in recent decades, in part because of sport's broad popular appeal, but also because its industry structure – essentially a bilateral monopoly – is not found in most other industries.

While there have been many journal articles written by sports economists that would fall within the topic area (personnel economics in sport), there is an overall absence in the literature of any attempt to pull this body of knowledge together into a more unified theme. These journal articles, by their very nature, have been 'stand-alones', and, in most cases, the authors never explicitly identify that their work falls within the broader field of personnel economics. This book will attempt to show that these individual works, when looked at more broadly, all deal with the employment relationship in a firm. As such, the book presents the important research findings in a more systematic, structured, and unified way, and shows that sports economics can inform all facets of the employment relationship – from recruiting and selection, to pay and performance, to work team design.

The book is organized into eight chapters. In Chapter 1, Neil Longley first provides a basic overview of the broad field of personnel economics, examining some of its key research questions and approaches. He then discusses how this broader field can be applied specifically to professional sport, particularly focusing on the peculiar institutional mechanisms in sport that potentially impact this application. Chapter 1 serves as both a background and a contextual foundation for the chapters that follow.

The remaining chapters are organized around the functional areas of personnel economics. Part I (Chapters 2 and 3) deals with recruiting, Part II (Chapters 4 and 5) with pay, performance, and incentives, and Part III (Chapters 6 through 8) with the organization of work, which includes the functioning of work teams and also the roles and impacts of management.

In Part I, the two chapters on recruiting illustrate the fundamentally different institutional structures found in North American pro leagues versus European soccer – in North America, the entry point for players into the pro leagues is through the draft system, whereas in Europe, individual clubs recruit players at a very young age and develop them through their own training academies.

The North American system is discussed in Chapter 2, written by David Berri. He focuses on the player drafts in the National Football League (NFL) and the National Basketball Association (NBA), and argues that the collective track-record of teams is not particularly strong in being able to identify which players will ultimately be the most productive at the pro level – in other words, the draft-position at which a player is selected is not always a reliable indicator of his future success as a pro. With the NFL, Berri focuses on quarterbacks, and attributes the results to the general inability of a player's college performance to predict his performance as a pro. In the NBA, he argues that the reason for the lack of predictability in the draft is not so much that college performance is unrelated to a player's pro performance – in fact, some college statistics are correlated with productivity as a pro – but more due to the fact that NBA teams tend to make systematic errors in evaluating the information presented to them.

They tend to overvalue, for example, both a player's scoring in college, and the number of wins of the team for which he played. In other words, the factors that drive a player's draft position are not necessarily the same factors that drive that player's contribution to team wins at the NBA level.

Chapter 3, written by Joachim Prinz and Daniel Weimar, continues with the recruitment theme. Prinz and Weimar focus on the youth training academy system in German soccer. They note that the academy system acts not only as a long-term screening function (i.e. a long-term probation), but also has a training and development purpose whereby teams impart both general soccer-related skills to youth as well as club-specific skills, knowledge, and attitudes. From a recruiting perspective, the training academies allow the clubs to gain private information about players, helping the club to ultimately determine the quality of the club-player match. Prinz and Weimar report that only 2 to 5 percent of youth players in an academy ever go on to enter professional soccer, so, from the club's perspective, the return on investment from these players must be sufficient to cover the costs associated with the other 95 to 98 percent who do not make it to the pro level. They also detail several impediments to effectively identifying the best youth players, including the continued long-term persistence of the so-called 'relative age effect'.

Taken together, Chapters 2 and 3 illustrate how difficult it is to forecast future performance in sport, whether it be a North American-style draft system or the academy system of European soccer. This difficulty occurs even when worker (i.e. player) performance is much more easily measured in the sport industry than it is in non-sport industries. As much as human resource professionals may like to be believe that they can consistently identify 'stars' well in advance, the evidence suggests otherwise. This brings into question the amount of resources that firms – whether they be sport or non-sport – should be devoting to such forecasting.

Part II of the book – containing Chapters 4 and 5 – examines the relationship between pay, performance, and incentives. These are, by far, the most studied topics in personnel economics. In Chapter 4, Christian Deutscher provides an overview of the literature studying player performance and salaries. He argues that the 'traditional' approaches tended to view the drivers of salary for a player as falling into one of four broad categories – experience, performance, talent, and popularity. However, he notes that using just these traditional drivers is deficient, in that, collectively, they usually fail to explain 30 to 40 percent of the variation in salaries. He then discusses new advances in the literature that attempt to better incorporate into salary models factors like non-cognitive skills and work habits, and explains how researchers are now examining such player-characteristics as leadership skills, performance under pressure, and performance volatility to determine which, if any, of these factors may impact salary. Deutscher also notes how traditional measures are being enhanced by technological advances that better capture on-field performance, and by new metrics that attempt to summarize a variety of, sometimes disparate, player-performance outcomes into a single comprehensive statistic, such as wins-above-replacement (WAR).

In Chapter 5, Joel Maxcy examines issues related to contract-length in sport. He notes that the literature has focused both on identifying the rationales for multi-period contracts, and on measuring the impacts of such contracts on players' incentives to shirk. Maxcy is particularly interested in the observed phenomena in baseball where players on long-term contracts also receive a salary premium – a result that is counter to the standard hypothesis that workers on long-term contracts transfer their performance risk to clubs, and hence should be willing to accept a salary penalty for such transference. Maxcy discusses a possible reason for this empirical finding – high-skilled free agents are difficult to replace, and teams may be willing to enter long-term contracts to protect against future increases in the market price for these players' services. In his empirical work, Maxcy finds that both player performance and free agent status (as opposed to players that are only arbitration-eligible) independently increase the probability of a player receiving a long-term contract.

Part III includes Chapters 6, 7, and 8, and examines the economics of workplace interactions, including building effective work teams, and assessing the role and importance of management. Robert Simmons authors Chapter 6, and his focus is co-worker heterogeneity. He examines the extent to which workers impact each other's productivity. Simmons reviews some of the key literature examining the impact on team performance of factors such as (i) potential productivity spillovers across teammates, (ii) heterogeneous abilities among teammates, and (iii) cultural diversity within a team. In addition to these, he notes how pay dispersion within a team may also be important to team performance, and highlights some of the key literature in that area.

In Chapter 7, Leo Kahane more comprehensively examines this pay dispersion issue first raised by Simmons in Chapter 6. Kahane contrasts the two competing theories related to pay dispersion – the tournament model versus the fairness model. In Kahane's empirical work, he examines pay dispersion in the National Hockey League in the three seasons just prior to, and the three seasons just after, the 2004–05 season-long work stoppage that ultimately resulted in a collective bargaining agreement that drastically compressed salaries in the league. His empirical results lend strong support for the fairness model, meaning that lower within-team pay disparities result in, all else equal, higher team performance.

Chapter 8, written by Bernd Frick, examines the impacts of coaches on team performance. Frick focuses on soccer, and analyzes the impact of head coach dismissals on the subsequent performance of the team. He examines some of the methodological difficulties in studying such a question, and highlights some of the important research in the area. He notes that, while the specific results vary widely across papers, there seems to be no strongly consistent evidence that coaching changes fundamentally improve team performance.

Taken together, the chapters in this book are intended to provide the reader with a sense of the types of sport-related work being done within each of the broad functional areas of personnel economics. Each chapter contains a thorough literature review that, while not exhaustive, provides the reader with a sense of the breadth and depth of the work being done in the area, and can help inform the various ways in the which the literature can move forward, both in a sport and non-sport context.

Neil Longley

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