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World of Labor
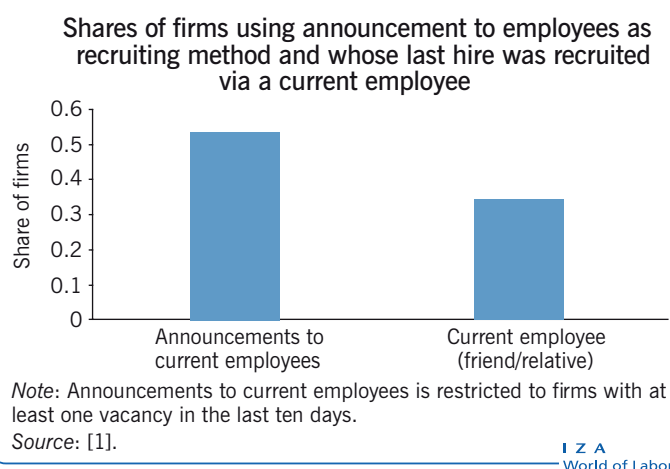Evidence-based policy making

The value of hiring through employee referrals in developed countries

Firms can benefit by hiring employee referred candidates; however, there are potential drawbacks that must be considered

Keywords: referrals, hiring, social networks

ELEVATOR PITCH

Companies frequently hire new employees based on referrals from existing employees, who often recommend friends or family members. There are numerous possible benefits from this, such as lower turnover, possibly higher productivity, lower recruiting costs, and beneficial commonalities related to shared employee values. On the other hand, hiring through employee referrals may disadvantage under-represented minorities, entail greater firm costs in the form of higher wages, lead to undesirable commonalities, and reflect nepotism. A growing body of research explores these considerations.

Shares of firms using announcement to employees as recruiting method and whose last hire was recruited via a current employee

Note: Announcements to current employees is restricted to firms with at least one vacancy in the last ten days.
Source: [1].

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KEY FINDINGS

Pros

⊕ Employees that are hired via referrals have lower turnover relative to non-referred employees.

⊕ Referred employees may have higher productivity than non-referred employees.

⊕ Firms may incur lower recruiting costs when hiring employees via referrals.

⊕ "Good homophily": When firms hire referred employees, their workforce becomes more likeminded; this can be a positive if workers share values or characteristics that are desirable.

Cons

⊖ It is possible that hiring based on employee referrals could disadvantage women or minorities.

⊖ Referred employees sometimes receive higher wages relative to non-referred employees, which entails increased costs to the firm.

⊖ "Bad homophily": Firms get employees like their existing employees; for example, firms might get less demographic diversity and/or employees with less diversity in opinions and ideas.

⊖ Referral hiring may reflect nepotism; friends and family may be hired instead of the best available candidates.

AUTHOR'S MAIN MESSAGE

Evidence increasingly supports the idea that firms can benefit from hiring through employee referrals. At the same time, this hiring method can entail various costs that firms must consider. While data constraints have typically limited research on hiring through employee referrals, significant research progress is being made. Additional future research using natural experiments and/or randomized experiments may be particularly fruitful.