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Nominees

for

CBS's Presidential Award for Most Imaginative Paper

Frank Neffke and Martin Henning: “Skill relatedness and firm diversification”



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Abstract

Human capital and skills are the prime resources in modern economies. The competitive advantage of firms and even of entire countries crucially depends on the capabilities of the workforce. This human capital is often specific to the job of an individual. When changing jobs, an employee often has to accept that a significant part of his or her acquired skills will become obsolete. This is especially true when an employee moves to another industry. However, such destruction of human capital can be limited by moving to related industries. Therefore, cross-industry labor flows should be stronger the more related the industries are. Based on this observation, we develop a method to measure skill-relatedness between industries using detailed information on cross-industry labor flows. This allows us to conceptualize the entire economy as a network of industries that are connected to one another in terms of similarities in the human capital they use. We test the empirical validity of this skill-relatedness index by investigating corporate diversification patterns. Controlling for value chain linkages, we find that firms are over 100 times more likely to diversify into skill-related industries than into skill-unrelated industries as defined by our index.