Reputation Management and Seniority Systems in Firms*

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Abstract

This paper studies the role of a seniority based profit and task allocation system in a firm. The firm chooses either a farsighted or a shortsighted action in each period. The former corresponds to keeping or rebuilding a good reputation, while the latter to cheating consumers or giving up rebuilding. We assume that even if the firm chooses the farsighted (shortsighted) action, it may get a bad (good) reputation with positive probability. In this situation, we show that an efficient seniority system helps to maintain a good reputation in the sense that the farsighted action profile is sustainable in equilibrium. This is because under the seniority system, the decision-maker of the firm gives attention to both short- and long-term performances.

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