

# Covenants not to compete and firms' recruiting strategies

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December 29, 2010

## Abstract

There is a proverb that says “a little bird is content with a little nest.” This paper studies whether this is true for firms' recruiting strategies under the possibility of labor turnover. Firstly we show that if there is a possibility of labor poaching by newcomer firms, some of the existing firms may use a “poaching deterrence” strategy under which the firms employ moderate ability workers instead of high ability workers and operate without the fear of labor turnover. In this case, the workers may not be employed in the order of ability and the employer-employee matching may not be efficient. Next we study the role of covenants not to compete (CNCs) and the legitimacy of such terms. As is well known, some countries and states (e.g., California) forbid CNCs and others not. We show that the government sometimes faces a tradeoff relationship between ex ante efficient employer-employee matching and ex post efficient allocation of talent among the existing and the newcomer firms. This fact helps to understand the co-existence of diverse laws in the US and other countries.

**JEL classification numbers:** J21, J24, J41, J62, J63, K31.

**Keywords:** Covenants not to compete, employment decision, labor mobility, labor poaching, non-compete clause, turnover.

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