

Optimal Contracts for Human Capital Acquisition and Organizational Beliefs *

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This study examines the effects of organizational beliefs on incentives to acquire human capital in a dynamic moral hazard model. In the model, a principal hires an agent for two periods, who then implements an identical project in each period. The project's outcome depends on both the agent's effort and ability level. In the second period, the agent can develop his ability level. The key feature of the model is that the principal and the agent openly disagree and have differing prior beliefs on the success probability of the ability development. The agent's belief regarding learnability has two conflicting effects: (i) it increases his incentive to work and develop his ability after failure, but (ii) it is counterproductive in the first period. The principal's belief regarding learnability determines optimal level of organizational beliefs. Furthermore, my results imply organizations will share homogenous beliefs, and have empirical implications for the relationship between biased beliefs and innovation.

JEL Classification Numbers: D82, D86, M50, A12.

Keywords: Differing Prior Beliefs, Human Capital Acquisition, Moral Hazard.

*Very preliminary and incomplete. Comments are welcome. Please do not circulate without the author's permission.

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