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Employee Retention Via Deferred Compensation

Abstract

We model deferred compensation as a share of an uncertain future profit granted by a financially constrained employer to her employee in mutual agreement. Deferred compensation serves as a retention mechanism, helping the employer to avoid bankruptcy. The optimal combination of cash and deferred payments that a firm can use to retain qualified personnel depends on the cost of new credit and bankruptcy risk: If interest rates are greater (smaller) than the ex-ante odds of bankruptcy, the employer will to defer compensation (pay in cash) to the employee.