CENTRO STUDI IN ECONOMIA E FINANZA

CENTRE FOR STUDIES IN ECONOMICS AND FINANCE

WORKING PAPER no. 5

Recommendations in the Italian Labour Market: An Empirical Analysis

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June 98

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Abstract

In this paper I focus on one of the most peculiar features of the Italian labour market: the importance played by recommendations in the hiring of new personnel. It is usually argued that, in contrast with the experience of other industrialized countries, in Italy letters of reference are not used to signal job applicants' qualities, but only to obtain a favoured treatment in the hiring process. Anecdotal evidence suggests that firms have used those practices both to overcome rigid hiring regulation and to weaken unions' power. In the empirical analysis, conducted on data drawn from the 1991 Bank of Italy Survey of Household Income and Wealth, I show that while workers seeking through recommendations increase the chance of being hired, they also pay a "recommendation fee" vis-a-vis workers hired through more traditional mechanisms. I provide various explanations for these results.

KEY WORDS: Labour market imperfections, Earnings function

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I received useful comments on a very preliminary version from Tullio Jappelli and Alfonso Rosolia. Needless to say, all errors are mine. Financial support from the Italian Ministry of Universities and Scientific Research is gratefully acknowledged.

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1. *Introduction*

This paper is an attempt to shed light on one of the most peculiar features of the Italian labour market: the role and importance of recommendations.[2] Based on data drawn from the 1991 Bank of Italy Survey of Household Income and Wealth, a representative survey of the Italian population, we show that recommendations are widely used as a device to access the labour market. For instance, more then 40 per cent of workers report to have obtained their current job through a recommendation; moreover, one unemployed or first-job-seeker in three reports to be currently seeking a job by checking with relatives and friends rather than relying on public employment agencies or other formal job search mechanisms. We also report evidence showing that it is more likely to be hired when using a recommendation than when using any other job search strategy.

Yet, obtaining a favoured treatment in the process of hiring does not come without costs: we show that while recommendations do increase the probability of receiving job offers, they also generate a sizeable pecuniary loss. In a regression of annual earnings onto human capital variables and a dummy for whether the worker was hired through a recommendation, the latter displays a negative and statistically significant coefficient. This finding appears robust to various changes in specification.

The evidence above can be reconciled with different stories related to the functioning of the Italian labour market, the most convincing one being that both firms and workers may found convenient to hire and to be hired through recommendations. On one hand, firms might have used the practice of hiring through recommendations to overcome rigid labour market regulation, weaken union bargaining power and reducing hiring costs; on the other hand, seeking work through recommendations might be

[2] In what follows, I assume that a worker is hired through a recommendation if she obtained her job as a consequence of a signalling process made by relatives, friends or acquaintances to the potential employer. The hiring of recommended workers is seen as an unpleasent feature of the labour market because workers' merits are valued less than letters of references.

convenient for workers too, as it entails less pecuniary and time search-related costs and seems more successful in terms of job offers.[3]

A possible argument against the existence of the trade-off mentioned above is that in equilibrium all workers will choose to be judged according to their merits rather than on the basis of recommendations (in particular, if the present discounted value of the income loss exceeds that related to the delayed entry in the labour market). However, people may still prefer seeking work through recommendations if the competition amongst job seekers is fierce, an effect that is particularly strong in a country where youth and long-term unemployment rates are well above European standards and where individuals display clear preferences for job security and earnings stability.

As an interpretation of our results, we argue that low pay and recommendations might be related simply because the dummy for recommendation picks up the effect of unobservable low skills and ability; in other words, had we available a consistent measure for unobservable skills, the negative effect of recommendations on wages would probably disappear.[4]

The rest of the paper is organized as follows. In section 2 anecdotal evidence is summarized and some extensions are considered; in section 3 we analyse the data used in the empirical part; section 4 deals with a discussion of the results; section 5 concludes. An Appendix details labour hiring regulations in Italy.

[3] This is also argued by Holtzer (1988). Seeking work through recommendation is less time consuming as individuals rely on friends, relatives and acquaintances' help, rather than committing themselves to an active job search. Recommendations might also be cheaper than, say, relying on a "head-hunter" agency because no fee is paid to the friend, relative or acquaintance who provided the job.

[4] Alternatively, one should estimate a fixed effect model for earnings at times t and t+1. For identification purposes, the sample should include individuals who changed their job between t and t+1 and who obtained the first job with a recommendation and the second without (or vice versa).

2. *Recommendations in the Italian labour market*

I first need to explain the importance played by recommendations in the Italian labour market. In contrast with the experience of other industrialized countries, where letters of recommendations are used by firms as a signal for the high quality of a job applicant,[5] in Italy letters of reference may well not signal any worker's characteristics at all, being just a way to obtain a favoured treatment in the process of hiring.[6]

In general, informal (or even illicit) practices arise when markets do not function according to the walrasian paradigm: for instance, when credit markets are imperfect usury and pawnbroking proliferate. A similar argument applies to the labour market as well. Given the available job opportunities and workers' characteristics, a perfect labour market would allocate individuals to available jobs according to a "matching" mechanism. In other words, in a labour market with complete and frictionless information, letters of references (or recommendations) should play no role. A worker would be hired according to observable characteristics (for instance, human capital factors such as labour market experience, education, etc.) and the firm would always be able to obtain reliable information about workers' prospective productivity. Thus, we argue, recommendations may only arise as one of the possible outcomes of labour market imperfections or asymmetric information.[7]

[5] An obvious example is given by the academic job market (or also by the process of application for a Ph.D. in a prestigious University). To lower levels of the occupational scale, letters of reference provided by previous employers may be useful to ascertain workers' quality and other characteristics (such as loyalty to the firm, committment to overtime work, etc.).

[6] One might argue that in the absence of reliable data this argument is at best debatable, or that recommendations are not necessarily bad in all circumstance. Given that recommendations usually represented a violation of hiring regulations (see the Appendix), data on this issue are obviously lacking. The only source of evidence we can rely on is of forensic or anecdotal nature, and it is on latter that the argument above is based.

[7] Other unpleasant features of the Italian labour market are often empirically neglected. This is mainly due to lack of reliable data. For instance, very little is known about the extension and the functioning of the underground labour market (allegedly involving some 4 millions workers in 1995).

One such imperfection was probably the tight constraint imposed by the regulation on hiring and firing in force until 1991. In some circumstances, firms had no decisional power whatsoever in the process of hiring of new personnel. When recruiting was needed, they were to submit a request to the local public employment agency (*Ufficio di Collocamento*); workers were then allocated to the firm according to a pure ranking criterion, irrespective of skills. It is therefore not surprising that firms tried to overcome hiring regulations by relying on informal (actually, illicit) practices such as recommendations. Since job vacancies could not be publicly advertised, direct contacts with the work force or intermediaries were used, thus creating a self-sustaining development for recommendations.

Recommended workers might simply be more informed than other job-seekers about job vacancies and wage offers (this is particularly the case in small labour markets). Alternatively, they might overpower non recommended workers of similar (or even higher) abilities and skills by exploiting the strength of a recommendation. This raises the problem of knowing how much a recommendation costs, and whether a formal price is in fact posted. Unfortunately, to draw such knowledge there is no other possibility than relying on anecdotal evidence or common presumptions.

In some cases, individuals bequeath the job to their child by renouncing to some end-of-career compensation (such as the *liquidazione*);[8] the firm only requires the \textit{heir} to possess a minimum level of education needed to access the post. Very little is known about the legitimacy of such practice. In other cases, the employer is a friend or a relative's friend; the reference may even be costless in this case, and it is hard to oppose legal exceptions (unless a job allocation scheme needs to be fulfilled, such as the one imposed by the *chiamata numerica* regulation, see the Appendix). Finally, a reference might be paid a market price; the price is probably higher as safer or better-paid is the targeted job. The price has not necessarily a monetary equivalent; for instance, prospective Members of Parliament may promise a job (or their commitment to help or signal) against a given number of votes provided by the buyer.[9] More frequently,

[8] The practice seems to be still in force, especially in the banking sector.

[9] Forensic evidence shows that this has often occurred (the most famous cases probably being those of the Mayor of Naples Achille Lauro in the 1950s, and MP Angelo Vito, the *one-million-votes-man* in the General Elections of 1987). The latter was convicted

the reference is obtained via a monetary payment. There is probably an explicit agreement (and a sharing of the price paid by the buyer) between the seller and the firm's representative (the owner, an influential shareholder, a member of the CEO, etc.). It is clear that this practice is illicit, although it can be very difficult to detect.[10]

3. *The data*

This section briefly describes the construction of our sample. We use the 1991 Survey of Household Income and Wealth (hereafter, SHIW) conducted by the Central Bank of Italy in March-May 1992. The SHIW is widely used in empirical work since it contains information on income, consumption, wealth, household characteristics, and individual labour supply. For more details about the survey, the interested reader is referred to Brandolini and Cannari (1994).

For each survey, a sample of about 8,000 households is interviewed. The survey is conducted in the first quarter of the following year and all the variables refer to the previous calendar year. The unit of observation is the *de facto* household, which includes all persons residing in the same dwelling and who are related by blood, marriage, affection, or adoption. Households are randomly selected through a two-stages-stratified sampling procedure, and the design of the survey is such that the final sample is representative of the Italian population. Since 1989, the survey also contains a small panel component.

for having promised employment opportunities to his potential voters against votes. The "clean hands" investigation has shown that the practice was widely used as a mechanism to obtain votes at general or administrative elections. The phenomenon at issue has been known as the "exchange vote". Commentators refer to the sharp increase in public sector employment occurred in the 1970s and 1980s to give further strenght to this argument.

[10] Recommendations are not a peculiar characteristic of the labour market, though. Italians seem to be particularly prone to use recommendations almost in any aspect of their social life. Popular press has often reported scandals of people recommended even to obtain their school licence or to get a pass at university exams. Recommendations are also used to avoid the compulsory military service. Very recently, the public manager of the state-owned Railways company admitted the presence in his company of personnel hired through recommendations.

Since entrepreneurship does not require a formal hiring process, we exclude the self-employed and focus only on household heads working full-time in the public or private sector. The original data set included 3,509 such individuals. For obvious reasons, we decided to exclude those working in the public sector (1,393 observations). This due to the fact that, at least in principle, jobs in the public sector can only be obtained by competition, not by recommendation; however, there is some evidence that this legal requirement has been violated quite regularly, and our data actually confirm such disappointing evidence.[11]

We also exclude individuals aged above 65 or below 20 (6 observations), those working in agriculture (123 observations) and those with missing values on the variables we use in the empirical section (56 observations). Finally, to avoid our estimates to be contaminated by influential values or measurement errors, we trim the sample at the bottom and top 1 per cent of the distribution of earnings (37 observations). The final sample used in this study includes 1,894 individuals.

The 1991 SHIW contains a special section (section B9 of the questionnaire) collecting information on job mobility and job search. The survey question we use to discriminate between recommended and non-recommended workers is the following:

"How did you get your current job? (Please provide just one answer)".

Possible answers are:

i) through a public employment agency (*Ufficio di Collocamento*);

ii) through an open competition in the public administration or other public institution;

iii) replying to a job advertisement published on a newspaper/magazine;

iv) sending a CV to a potential employer;

v) through a "head-hunter" agency (without replying to any advertisement);

vi) through signalling made by friends, relatives or acquaintances to a potential employer;

[11] Ironically enough, 187 out of 1393 people working in the public administration naively admitted to have been hired through references.

vii) inserting CV in a data-bank;

viii) helping a relative in his/her job;

ix) becoming self-employed;

x) receiving a direct job offer by a firm;

xi) other.

For the purpose at hand, individuals choosing option vi) are labelled as `'recommended"; individuals choosing any other option are instead labelled as "non-recommended". Table 1 shows that 47 per cent of individuals in our sample obtained their current job through a recommendation. This is a striking figure, in particular if one considers the tight regulation on hiring procedures in force in Italy until 1991 (see Appendix).

People interviewed in the 1991 SHIW are also asked to report how they are seeking work (if any). Possible options are again i) to xi) as in the question above, but up to three different answers are allowed. For the sub-sample of currently unemployed job seekers, we find that seeking work through recommendation is not the preferred first option (it is chosen by only 10 per cent of job seekers). However, when we focus on individuals choosing just one option, we find that seeking work through recommendation is the preferred search strategy for roughly 32 per cent of the sub-sample.

4 *The results*

Table 2 presents simple statistics for the two groups of workers we are dealing with. As the table shows, recommended and non-recommended workers are on average quite different. Workers hired through a recommendation are less educated, with less labour market experience and more likely to live in the Middle. Recommended workers are also more likely to live in a small town (perhaps because in the local labour market hiring regulations can be violated more easily). As far as labour market characteristics are concerned, they work more hours,[12] but their earnings are

[12] This is perhaps a symptom of the fact that some individuals in this group are actually working in the underground economy.

lower; the majority of them work as blue collar in the manufacturing or the construction industry, while very few of them work as managers in the service industry. Finally, they are more likely to have lost working days because of illness. On average, workers who obtained their job with a recommendation also spent less time unemployed than those who obtained it using more traditional search strategies (3.37 vis-a-vis 3.49 years).[13]

Another way to answer the same question is to use data on more than a single year. To this aim, I construct a panel of individuals surveyed in both 1991 and 1993. There are 4242 such individuals. Of them, 598 (or 14 per cent of the sample) reported to be unemployed in 1991 and currently seeking work. We decided to focus our attention on this group; this is because we are more likely to assess the effect of recommendations on employment opportunities by looking at individuals whose initial state is that of unemployment and whose arrival state depends on individual and market characteristics. In other words, we can assess whether labour market transitions are affected by recommendations.

In table 3 we show the search strategies adopted by these individuals; as said above, while searching trough recommendations is not the most preferred option (it is chosen by only 11 per cent of the sample), it is an option abundantly picked up by people seeking through different channels. Next, we examine labour market transitions between 1991 and 1993. These are reported in table 4. The majority of the 1991 unemployed job-seeker is still unemployed in 1993, while roughly 20 per cent of our sample make a transition towards employment. Table 5 shows that about 40 per cent of the latter were employed through a recommendation. From this evidence, we are in position to confirm that recommendations do help finding a job more easily (and perhaps more quickly) than any other job search strategy available to the unemployed.

In table 6 we relate log-earnings to human capital variables (Willis, 1978), job characteristics, and the dummy for a recommended worker. We present three different specifications: (1) one with labour market experience

[13] This is obtained as (age-education-experience-6): it is the number of years between school leaving age and age when firstly entrying the labour market. It is fair to say that, due to measurement errors, it might a very poor measure of the variable of interest. This confirms the idea that a recommendation increases the chance of finding a job and that recommended workers obtain it earlier.

and its square term, education, gender, region of residence and the dummy for recommendation; (2) adding industry dummies; (3) adding occupation dummies. In the simplest specification the dummy for recommended workers displays a statistically significant coefficient of -0.046. Adding job characteristics to control for industry or occupation earnings differentials reduces the point estimate of the effect, but in the extended specification (3) being "favoured" in the process of hiring still amounts to a negative premium of about 3 per cent. At the sample means, and after controlling for differences in human capital, demographics, and job characteristics, being recommended amounts to the payment of an annual "fee" of roughly 1 million lire. In absolute value, being recommended appears to be more costly then giving up school one year earlier. Different explanations can be provided for this result.

First, it could reflect the low quality or low skills of individuals unable to get a job according to market forces;[14] second, it could be related to the fact that a portion of those hired through recommendations are probably working in the underground economy (where of course labour market regulations are violated by definition); third, the firm could pay low wages to workers hired through informal or illicit practices as a sort of *closed box* compensation (i.e., for the fact that they hire untested workers) or in order to be compensated for the fact that recommended workers experiment shorter unemployment spells that the non-recommended; fourth, as argued by Holzen (1988), individuals who search using references provided by friends or relatives are actually those who invest less in the search activity and then face less search costs, so that the fact of being impatient (which is reflected in their preferred search strategy) can lead them to accept the first job offer they receive, which may be well a low one. A final possibility is that workers of this type "are not taken seriously", i.e. that the employer forms some belief about their (presumed low) ability; since it takes some time

[14] The fact that the dummy for recommended workers is negative and statistically significant could meet the kind of criticism raised by Di Nardo and Pischke (1997) against Kruegers (1993) finding that the introduction of computers generated a positive wage premium of nearly 12 per cent in the US. Di Nardo and Pischke show that this is due to the very simple fact that the dummy for computer is proxying for unmeasured ability characteristics, rather than representing a genuine "causal" relationship. Likewise, one might argue that in our context the dummy for recommended workers is negative and significant simply because is proxing for the low ability of those searching and getting jobs through informal practices.

before updating beliefs and ascertaining workers' productivity on the job, and since salary progression is usually strictly tied to seniority rules, recommended workers may end up being paid less than observationally equivalent individuals because of the initial belief held by the employer.

If the first interpretation we provided is valid, our empirical results give rise to some concern. One worry is that low quality "recommended" are crowding out high quality "non-recommended" workers from available employment opportunities. Due to the heavy regulation prevailing on the Italian labour market, the inefficiency generated by hiring low quality "recommended" workers instead of high quality "non-recommended" workers tends to increase over time, as firing costs are exacerbated by the extension of union protection and labour market seniority.

5. *Conclusions*

In this paper we have tried to uncover the statistical relationship between earnings and the likelihood of being hired via a recommendation provided by relatives, friends or acquaintances. The paper is also a modest attempt to shed light on an issue that is widely discussed in the popular press, but that has never received attention at academic level.

When summarizing the results of this paper, one is faced with several empirical puzzles. First, roughly half of the workers in our sample obtained their job through a recommendation; yet, the Italian regulation on hiring procedures dictated that *ad-hoc* labour hiring was to be used only in extraordinary circumstances (see the Appendix). Second, more than 10 per cent of those working in the public sector report to have been obtained their job via a recommendation; yet, and by law, the access to public sector jobs can only occur by open competition, not by recommendation. Third, being a recommended workers amount to the payment of an annual average fee of 1 million lire vis-a-vis non-recommended workers. A possible explanation is that being recommended signals low productivity or low skills, or else that firms let recommended workers to pay a penalty for the favoured treatment they grant them in the process of hiring; but if the signal is so evident, one is

left with the puzzle of explaining why profit-maximizing firms do not use that signal on reverse, i.e. to screen recommended workers out.[15]

All these puzzles can probably be reconciled with the fact that the Italian labour market is highly imperfect and that only in recent times seems to have made its way towards "crossing the river" (Bertola and Ichino, 1995). Whether in the future merits will be valued more than recommendations remains an open question that goes beyond the scope of this paper.

[15] The "clean hands" investigation has shown that in some cases private firms were promised to win the bid for a public contract if they accepted to pay a bribe or hire workers recommended by those in charge with the appointment.

Appendix

Labour hiring regulations in Italy

Labour hiring procedures in Italy have been regulated by two laws: law no. 264, passed in 1949, and law no. 223, passed in 1991. Between these two dates, various legislative measures modified only slightly the rules of labour hiring established in 1949. According to law no. 264, the hiring of involuntary unemployed workers and those seeking work was to be supervised by public employment agencies *Uffici di Collocamento*), with very few exceptions (mainly in agriculture, the arts, and maritime and air transport). Firms willing to hire new personnel were to submit a request to the local public employment agency, which would provide them with a list of potential employees to be hired. Those were sorted according to qualifications and merits. This was knows as the numerical call (*chiamata numerica*) criterion. Exceptions to such criterion should have been rare. In particular, the discretionary power of firms in hiring new personnel was to be applied only to special categories of workers: the employers relatives, precision craft and highly skilled workers hired via an open competition, and those hired by firms whose size was below four. The alternative criterion to the numerical call was known as the nominative call (*chiamata nominativa*). The unbearable restrictions imposed by such regime generated high rigidity in the labour market and frequent violations of the law; firms circumvented the legal obstacles by interpreting the legislative measures at large. Recommendations raised in the legislative chaos. Due to such state of play, exceptions to job allocation schemes were extended by law to domestic workers (1973), apprentices (1987), those hired through solidarity contract (1984), young workers hired on a temporary basis through training contracts (*contratti di formazione e lavoro*) and receiving a firm offer for a permanent position up to 32 months after the expiring of their contract (1984), and workers with hiring priorities (e.g., those previously fired by the firm due to demand shortage). The job allocation scheme devised as far as in 1949 was eventually abolished in 1991 by the law no. 223. According to the latter, starting from 1989 onward (and hence retrospectively) firms willing to hire new personnel would apply fully discretionary procedures. Bertola and Ichino (1995) interpret the law no. 223/1991 as an important step towards flexibility in the Italian labour market.

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TABLE 1

HOW CURRENT JOB WAS OBTAINED

Methods used	Number of observations	Percentage
State employment agency	202	10.67
Public competition	243	12.83
Newspapers	73	3.85
Direct application	384	20.27
Signalling made by relatives/friends	891	47.04
Data bank	18	0.95
Self-employment	10	0.53
Others	73	3.86

TABLE 2
INDIVIDUAL CHARACTERISTICS

Variable	Recommended	Non recommended
Yearly labour income	21323.42 (6653.98)	23730.72 (7596.97)
Hours of work	42.27 (4.59)	41.69 (4.53)
Age	42.41 (9.48)	42.95 (8.85)
Years of education	8.15 (3.64)	9.71 (4.04)
Years of labour experience	24.88 (10.30)	23.74 (10.07)
*Male**	0.9517 (0.2144)	0.9432 (0.2316)
*Married**	0.8878 (0.3158)	0.8804 (0.3247)
*Living in the North**	0.4422 (0.4969)	0.4796 (0.4998)
*Living in the South**	0.3143 (0.4645)	0.3370 (0.4729)
*Blue collar**	0.7194 (0.4495)	0.5145 (0.5000)
*Manufacturing**	0.4837 (0.5000)	0.4845 (0.5000)
*Construction**	0.2009 (0.4009)	0.0957 (0.2943)
Working days lost because of illness	8.49 (17.15)	8.14 (15.54)
Small town	0.2379 (0.4261)	0.1545 (0.3616)
Large town	0.4186 (0.4936)	0.4397 (0.4966)
Metropolitan area	0.1414 (0.3486)	0.1994 (0.3997)
Number of observations	891	1,003

Notes: standard errors are reported in parenthesis. Variables labelled with * are proportions.

TABLE 3

SEARCH STRATEGIES OF THE 1991 UNEMPLOYED JOB-SEEKERS

Job search strategy	First option	Second option	Third option
State employment agency	356	0	0
Public competition	58	118	0
Newspapers	50	85	27
Direct application	42	72	35
Signalling made by relatives/friends	66	116	129
Database	0	4	8
Self-employment	7	3	4
Others	0	2	0
Not reported	19	198	395

TABLE 4

LABOUR MARKET TRANSITIONS IN 1993 OF THE 1991 UNEMPLOYED JOB-SEEKERS

Labour market status in 1993	Obs.	Percentage
Employed	117	19.57
Unemployed	395	66.05
Unemployment benefits	3	0.50
Occasional work	2	0.33
Not reported	81	13.55

TABLE 5

HOW 1991 UNEMPLOYED JOB-SEEKERS OBTAINED THEIR 1993 JOB

Methods used	Obs.	Percentage
State employment agency	5	4.20
Public competition	19	15.97
Newspapers	5	4.20
Direct application	16	13.44
Signalling made by relatives/friends	45	37.82
Database	0	0.00
Self-employment	13	10.92
Others	11	9.24
Not reported	5	4.20

TABLE 6
THE ECONOMIC RETURN FROM THE RECOMMENDATION

Variable	**(1)**	**(2)**	**(3)**
Experience	0.0210	0.0208	0.0169
	(0.0026)	(0.0025)	(0.0024)
Experience^2	-0.0003	-0.0003	-0.0003
	(0.0001)	(0.0001)	(0.0000)
Education	0.0408	0.0393	0.0183
	(0.0017)	(0.0018)	(0.0021)
Male	0.1552	0.1672	0.1688
	(0.0257)	(0.0260)	(0.0254)
South	-0.0169	-0.0133	-0.0270
	(0.0157)	(0.0157)	(0.0149)
North	0.0385	0.0393	0.0326
	(0.0148)	(0.0149)	(0.0138)
Manufacturing		-0.0214	0.0013
		(0.0132)	(0.0124)
Constructions		-0.0794	-0.0557
		(0.0182)	(0.0176)
Blue collar			-0.5724
			(0.0402)
Clerical			-0.4608
			(0.0376)
Craft precision			-0.2700
			(0.0380)
Recommendation	-0.0457	-0.0396	-0.0305
	(0.0119)	(0.0119)	(0.0111)
R^2	0.3025	0.3091	0.4055

Notes: standard errors are reported in parenthesis under the coefficients.