

# To Tell or Not To Tell: The Incentive Effects of Disclosing Employer Assessments

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## Abstract

Should employers disclose their assessments of their employees? Popular managerial advice suggests that telling an employee that she is assessed to have high potential leads to greater effort and engagement, boosting firm profits. However, some employers still choose to withhold employee assessments. What explains this observation? We show that if the internal accounting system is weak, telling an employee that she is assessed to have high potential increases her incentive to manipulate the accounting report instead of working harder, thereby decreasing firm profits. Thus, we explain why some employers withhold assessments.

**Keywords|** Talent management, information disclosure, performance evaluation, employee assessment, human resource management

**JEL Classification|** D21, D23, D82, D86, J24, J53

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# 1 Introduction

...the question of 'tell or don't tell' has been well and truly answered with a resounding 'yes.'

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James Peters

Senior Partner, Korn Ferry

Employers often have a good gauge of which junior-level employees have the potential to be leaders or managers within the firm (Ready et al. 2010). We call this gauge an employer's assessment of whether an employee has the potential to be successful in a leadership or managerial role. Should employers disclose (or tell) these assessments to their employees? The popular managerial guidance book, 'One Page Talent Management' (Eron and Ort 2010), suggests that many employers prefer to withhold their assessments<sup>2</sup>. Foremost, the authors of the book conjecture, employers worry that disclosing assessments might lead some employees to become discouraged about their prospects within the firm, thereby decreasing productivity. The authors bemoan this lack of transparency and argue why employers should be more transparent. In this paper, we suggest that this advice to be more transparent overlooks a vital determinant of the decision to tell { the strength of the firm's internal accounting system (that is, how easy or difficult it is for the employee to generate a false accounting report). We thus explain why some employers choose not to disclose assessments.

Popular managerial guidance books, advice from consulting firms, and prior literature have extensively focused on the employees' effort incentives who are told of their potential to advance within an organization. Common reasons for not telling employees include avoiding employee demotivation (Beer 1987) and reducing employee turnover. Reasons for transparency include increased employee

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<sup>1</sup> Disclosing assessments is different from providing performance feedback where the employer provides a specific evaluation of the employee's performance on a task without alluding to her potential to advance in the future. A helpful framework is to think of assessments as forward-looking information and performance feedback as backward-looking information about the employee.

<sup>2</sup> An informal survey estimates that 73% employers prefer not to disclose assessments: <https://talentstrategygroup.com/wp-content/uploads/2020/02/Calculating-the-Optimal-Length-of-Time-to-Lie.pdf>.

engagement and commitment and greater trust in the reward system (Lawler 1972, Hamner 1975, and Eron and Ort 2010). While the academic literature might not have reached a consensus on what should be done, consulting firms and managerial advice books advocate transparency. For instance, the epigraph above recommends that employers should disclose assessments. A sentence from another managerial advice book, 'Leading the Way' (Gandossy and Eron, 2004), reads, '...we think it is best to let high-potentials know their status... if there are real consequences to this status.'

Despite popular managerial advice, one in three employers prefers to withhold assessments as indicated by prior studies (Bournois and Roussillon 1992, Dries and Pepermans 2008, Silzer and

strategy regarding the screening test results before learning about them. Assumptions of this form are standard in the 'Bayesian Persuasion' literature pioneered by Kamenica and Gentzkow (2011). In reality, the employer can commit to a disclosure strategy by developing a reputation for disclosure or nondisclosure. We assume that the results of the screening test are verifiable. This allows us to avoid any signaling issues arising from the disclosure of the test results.

In Stage 1, the employee exerts effort into an entry-level task and subsequently submits an accounting report about the output generated. In Stage 2, the employee is potentially promoted to a managerial role. We note that, for simplicity, there is no moral hazard in the managerial role.





In addition to the decrease in output due to manipulation in a weak accounting system, another effect manifests. In our model, when the employee who (1) has low potential or (2) has failed in the entry-level task (or both) is promoted, the employer experiences a cost of incorrect promotion. Put another way, when the wrong employee (either due to her type or her lack of prerequisite knowledge or both) is promoted, funding this person leads to costly waste of resources. When the employee can manipulate the report in a weak accounting system, the employer makes an inefficient promotion. This additional cost of manipulation{ the costly waste of resources{ makes it further attractive for employers not to disclose assessments.

## 1.1 Background Literature

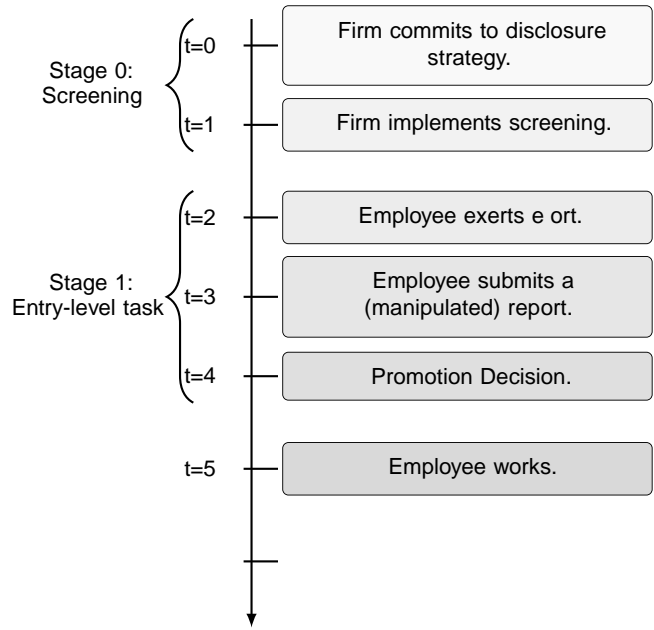
We contribute to the literature by explaining an apparent paradox as to why employers withhold employee assessments. This observation is particularly puzzling, given the wealth of advice suggesting the contrary. We provide a solution to this puzzle, which is the first of its kind to the best of our knowledge. Our solution links this observation to employee effort and the strength of the accounting system. Prior literature has focused extensively on the employee effort aspect while largely overlooking the accounting system's strength. For instance, Lizzeri et al. (2002) examine the effects of providing performance feedback on employee effort and how that affects the cost of the optimal contract. They conclude that not providing feedback is optimal since it reduces the expected cost of compensation. While we reach a similar conclusion, in our model, we demonstrate this without using a performance contingent wage contract by instead focusing on the strength of the accounting system. Hamner (1975) and Lawler (1972) provide various reasons (such as increased employee engagement and commitment) as to why employers should be transparent with their employees. We examine an outcome that is in contradiction to their recommendation.

In recent years, other papers have also looked at theoretical aspects of employers providing feedback to employees. For instance, Goltsman and Mukherjee (2011) and Aoyagi (2010) outline the optimality of no, partial, or complete disclosure of feedback in a tournament setting. Gershkov and Perry (2009) too examine performance reviews in a tournament setting; however, their focus is primarily on the timing of the performance review rather than the disclosure of the results. In Prendergast (1992), an employer observes the employee's ability after the first-period task and

uses a fast-track promotion to signal to high-ability workers. Our model avoids signaling issues by assuming the employer's assessments are formed due to a verifiable test.

Another related stream of literature examines communication between a principal and a better-informed agent. Specifically, this literature analyzes how optimal contracting or the use of management control systems can mitigate this information asymmetry (see for example Christensen (1981);







This difference is a measure of the attractiveness of the promotion. We assume that the employee is paid a guaranteed fixed-wage in each period, normalized to 0.

Stage 3 - Payo : In stage 3, the payoffs are realized.

Below, we list a few important assumptions.

Assumption 1.  $B > c$  that is, the promotion benefit is more desirable to an employee than the outside option.

Assumption 2. Ex-ante, without information about the employee's types, it is inefficient for the firm to continue the project. Equivalently, the probability of being the high type is sufficiently low. Formally, we assume:

$$X_2 < K$$

Assumption 3. To ensure interior solutions for the employee (0; 1) and manipulation (0; 1), we assume the following:

1.  $(B - c) < c$
2.  $(B - c) < k$

## 2.1 Discussion of Model Setup

A few elements of our model merit further discussion. First, we discuss the interplay of potential and knowledge in an employee's success in the managerial role. Only a high potential employee who has succeeded in the entry-level task can succeed in the managerial role in our model. To succeed as a manager, an employee needs to have the correct 'innate ability' (or potential) and knowledge (which comes from success in the entry-level task). This setup is typical in everyday situations. For instance, consider an audit firm. To be a partner, an auditor needs to have the right ability (such as networking skills or leadership or what we call potential in our model) and needs to know the basics of auditing, which only comes from doing well in the junior level positions. Consider another contrived example: Robert Lewandowski, one of the greatest soccer strikers of this generation, plays for the Bundesliga club, Bayern München. However, he is not the captain despite being an exceptionally skilled soccer player. It appears that soccer skill is only a necessary

condition to be a captain of a soccer team; not a sufficient condition. In the verbiage of our model, Lewandowski has the prerequisite knowledge of soccer; however, he might not have the potential to be the captain. Thus, we believe that our model setup, wherein the employer only promotes an employee who has successfully completed the entry-level task and has high potential, has a strong basis in reality.

Second, we explain the assumption that the employer commits to a disclosure strategy  $\alpha = 0$ . This assumption allows us to examine the effects of disclosure by preventing inferences by the employee. For instance, if the firm chose the disclosure strategy after observing the employee's type and chose not to disclose, the employee would make a negative inference about his or her ability. If the firm chose to disclose, the employee would make a positive inference about his or her ability. This assumption is reasonable because the employer's disclosure strategy is often based on the employee's performance, which is observed by the employer. If the employer chooses not to disclose, the employee would make a negative inference about his or her ability, which would lead to a lower wage. If the employer chooses to disclose, the employee would make a positive inference about his or her ability, which would lead to a higher wage. This assumption is also reasonable because the employer's disclosure strategy is often based on the employee's performance, which is observed by the employer. If the employer chooses not to disclose, the employee would make a negative inference about his or her ability, which would lead to a lower wage. If the employer chooses to disclose, the employee would make a positive inference about his or her ability, which would lead to a higher wage.

upon request. Additionally, Assumption 2 is not removed from reality. Indeed, in most settings, the number of high-potential types is much lesser than the number of low-potential types (or that is sufficiently small). For instance, audit firms often hire large 'sta' cohorts. However, only a tiny fraction of this cohort ever makes it to 'partner.'

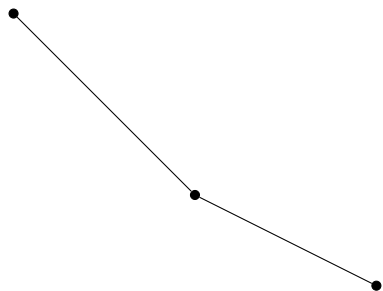
### 3 No Manipulation: Disclosure and Effort

In this section, we replicate some of the insights found in popular managerial guidance and prior literature. The critical element here is that the employee cannot manipulate the accounting report

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The employee obtains the following payo :





outside option independent of the effort level. The second term captures the cost of effort. Maximizing the above payoff with respect to effort is equivalent to minimizing the cost of effort. The low-type employee's equilibrium effort level is:

$$e_L^y = 0 \tag{9}$$

Under disclosure the firm's payoff is

$$U_F^{S;D} := s e_H^y (X_1 + Y) \tag{10}$$

The firm derives its payoff from the high type who is screened as such and has succeeded in the entry-level task.

### 3.2.3 Comparison of Efforts

Lemma 1. Without manipulation:

1. the high type chooses higher effort under disclosure relative to no disclosure.
2. the low type chooses lower effort under disclosure relative to no disclosure.
3. the high and the low types choose the same effort level under nondisclosure.

$$e_H^y > e > e_L^y = 0$$

The proof can be observed from the expressions for  $e_H^y$  and  $e_L^y$  given that  $0 < s < 1$  and  $(B > c) > 0$ . The intuition for Lemma 1 is straightforward and is similar to the Pygmalion effect described in Eden (1990). When the assessment is not disclosed, the uncertainty of the promotion weakens effort incentives for the high type while it strengthens effort incentives for the low type. When the assessment is disclosed, the high type anticipates a promotion as long as she succeeds in the entry-level task. Put another way, the high type's effort decision no longer hinges on the uncertainty about her type. This decrease in uncertainty increases the expected benefit of exerting effort, which is why  $e_H^y > e$ . However, when the assessment is disclosed to the low type, she rationally exerts no effort. This is because the firm would never promote a low type since she is

never successful in the managerial role. Thus, for the low type, a decrease in uncertainty reduces the expected benefit of exerting effort, which is why  $e_H^y > e_L^y$ .

Lemma 1 replicates some of the results found in prior literature and managerial advice. For instance, we show that telling a low-potential employee leads to decreased effort. This is similar to Beer (1987) and the reasons conjectured in Eron and Ort (2010) for why some firms withhold employee assessments. Another conjecture for why firms might not disclose assessments suggests that telling a high-potential employee leads to better outside options, which leads to lower effort. This can be demonstrated as follows. Assume that  $\beta$  is a function of telling, and that  $\beta(T) > \beta(NI)$  (in words,  $\beta$  of being disclosed as having high potential is greater than  $\beta$  of no information). Then, the comparison of  $e_H$  and  $e_L$  is not obvious.

$$e_H^y > e_L^y \iff B > \frac{\beta(T) - \beta(NI)}{(1 - \beta)} \quad (11)$$

We can see that if the benefit of promotion  $B$  is sufficiently small, then telling an employee could lead to lower effort (unlike the results of Lemma 1 where disclosure always leads to a greater effort from the high type). However, we believe that this conjecture is not worth pursuing because it is difficult for the employee to credibly convey to the outside market that her employer thinks she has high potential.<sup>10</sup> Moreover, a related line of reasoning has been explored in Waldman (1984), where the employee's promotion is used to convey the employer's positive perception credibly.

### 3.2.4 Optimal Disclosure Choice

We first tackle the question of whether conducting a screening test is optimal. For the employer to screen, it must be that  $U_F^{S;nR} > U_F^{nS} = 0$ , or  $U_F^{S;R} > U_F^{nS} = 0$ , or both. It can be observed from Equations (5) and (10) that both  $U_F^{S;nR}; U_F^{S;R} > 0$ . Thus, screening is always optimal for the firm.

The firm's decision to tell or not is more nuanced than its decision to conduct a screening test. The firm considers the following trade-off  $Td[(U)]TJ/F79owin051$ . HowHo3[(10)]TJ/F7F



makes disclosing the assessment a better option. In the next section, we show that nondisclosure of assessments arises, instead, due to the employee's ability to manipulate the accounting report and strength of the accounting system.

## 4 Manipulation: Disclosure and Effort

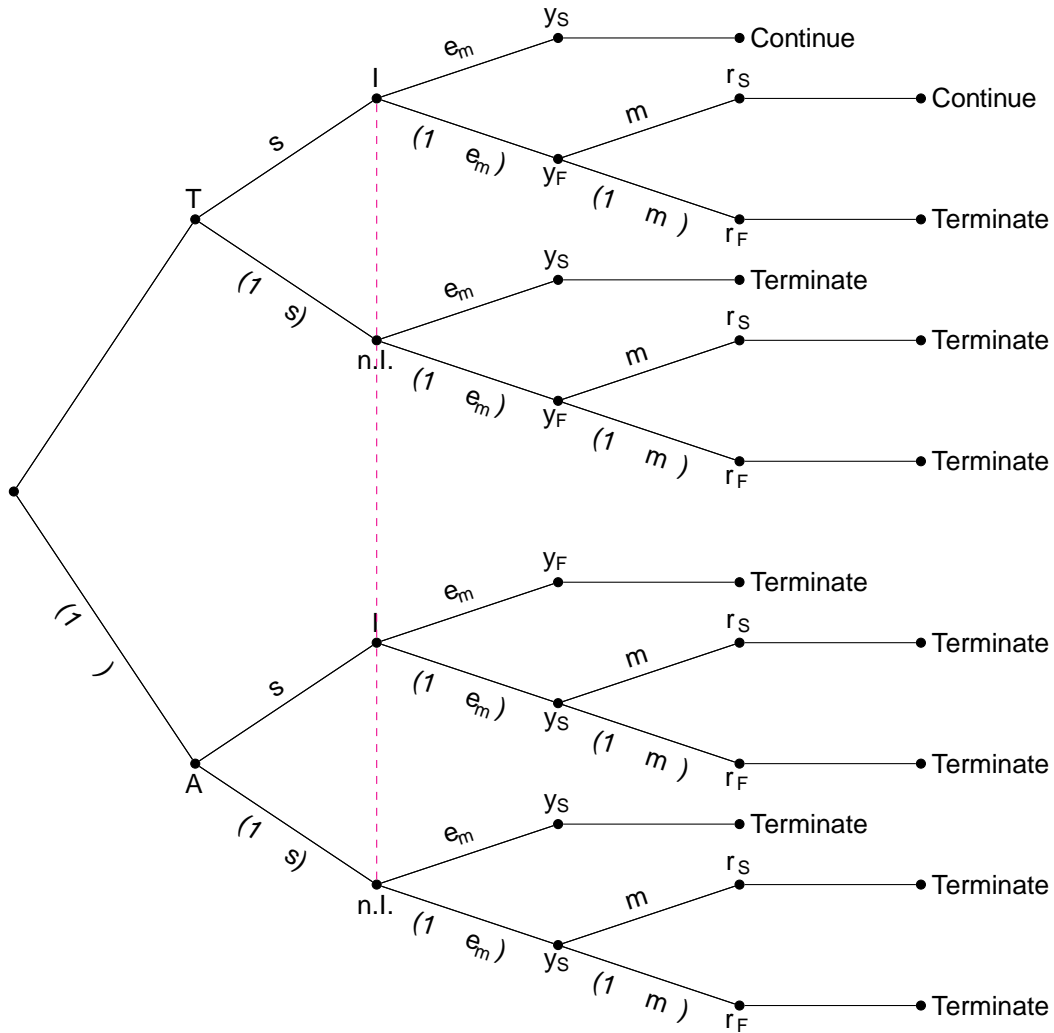


Figure 4: Game tree with screening without disclosure and manipulation

following equilibrium manipulation level.

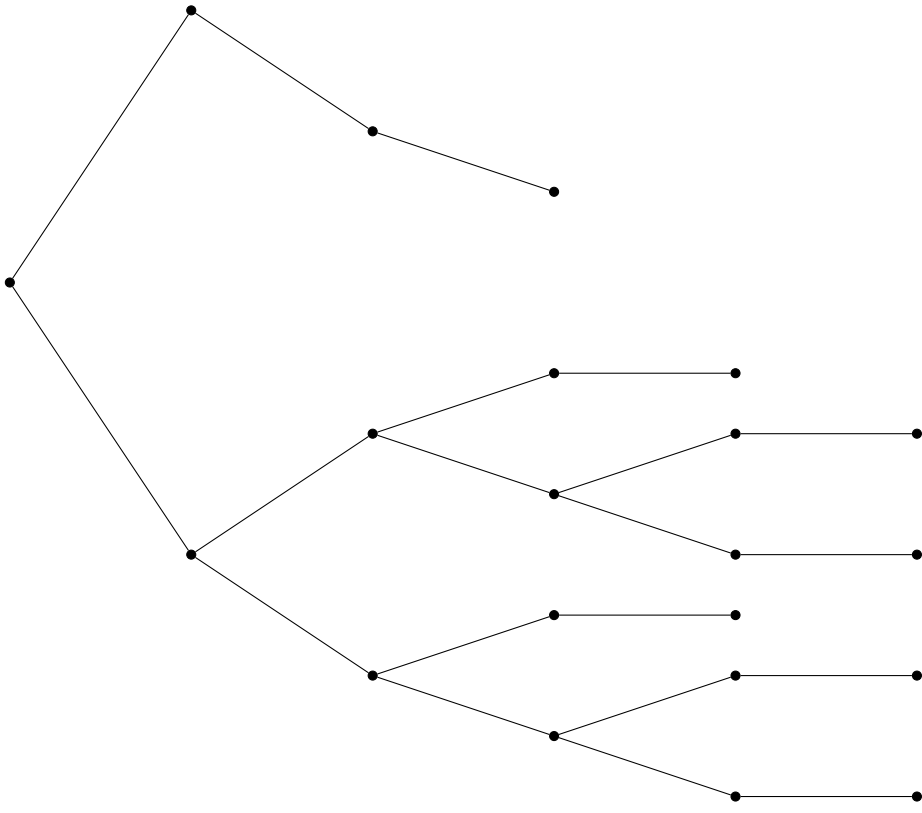
$$m_H = m_L = m = \frac{s(B)}{k} \quad (16)$$

We observe that the manipulation effort is increasing in the prior of being a high type, the probability of the screening test yielding information, and the attractiveness of the promotion. It is decreasing in the costliness of manipulation. By assumption 3,  $m \in (0; 1)$ .

Given the equilibrium manipulation level, the employee obtains (emplo) 2885

The first term captures the benefit of promotion over the outside option derived when the employee has high potential, is recognized as such, and succeeds in the entry-level task or manipulates the accounting report. The second term represents the guaranteed outside option for all other conditions. Finally, the third term is the cost of exerting effort. The employee maximizes the above payoff with respect to her effort yielding the following equilibrium effort level.

e



Given the high type's equilibrium manipulation level, she obtains the following total payoff :

$$eB + (1 - e)[m_H^y B + (1 - m_H^y) ] - \frac{ce^2}{2} \quad (22)$$

The first term above captures the promotion benefit given that the high type succeeds in the entry-level task. The second term represents the payoff when she fails (with probability  $1 - e$ ). The first term inside the parentheses is the promotion payoff obtained through manipulation, while the second term represents the guaranteed outside option when manipulation fails. The third term represents the cost of effort. The employee maximizes the above payoff with respect to effort yielding the following equilibrium effort level.

$$e_{H;m}^y = \frac{(1 - m_H^y)(B - )}{c} \quad (23)$$

$e_{H;m}^y \in (0; 1)$  because of assumption 3.

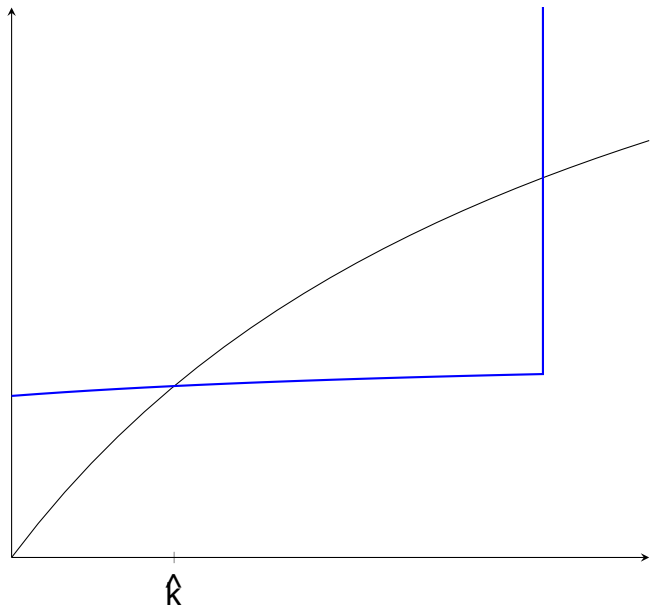
The employee who is disclosed to have low potential expects not to be promoted and thus, chooses  $e_{L;m}^y = 0$  and  $m_L^y = 0$ . The firm's payoff is of the form below:

$$U_{F;m}^{S;D} := s [$$



3. the high and the low types choose the same manipulation level under nondisclosure.

$$m_H^y > m > m_L^y = 0$$



than her effort under nondisclosure. The managerial output effect considers the incremental effect of disclosure on the managerial role's output,  $Y$ . Similarly, the resource-allocation effect considers the additional effect of disclosure on the cost of resources  $K$ . These last two effects can be both positive or negative, depending on whether  $e_{H,m} > e_m$  (and by how much).

**Proposition 2.** If  $k < \hat{k}$ , the managerial output and the resource allocation effects are negative. The firm strictly prefers to not disclose the assessment.

$$k < \hat{k} \Rightarrow U_{F;m}^{S;nD} > U_{F;m}^{S;D}$$

The proof is in the appendix. The intuition for the above result is that if the cost of manipulation is sufficiently low, the employee disclosed to have high potential manipulates more and exerts lower effort as compared to the employee who does not know the assessment (following Lemmas 2 and 4). Thus, disclosure leads to a decrease in the managerial role's output and a greater cost of inefficient resource allocation for the firm.

The above proposition explains why firms might choose not to tell employees. If the accounting system is sufficiently weak, disclosing positive assessments to employees leads to greater manipulation and lower effort, which hurts the firm's profit in three ways: by reducing the output of the entry-level and the managerial role, and increasing the wasteful allocation of resources. In such a setting with a weak accounting system, the firm is better off not disclosing employee assessments.

We now consider if screening is optimal in the setting with manipulation and nondisclosure. This is tantamount to checking if  $U_{F;m}^{S;nD} > U_{F;m}^{nS} = 0$ .

$$\Rightarrow c < \hat{c} = \frac{U_{F;m}^{S;nD} = e_m X_1 + s [e_m Y - (1 - e_m)m K]}{s k K} > 0 \quad (26)$$

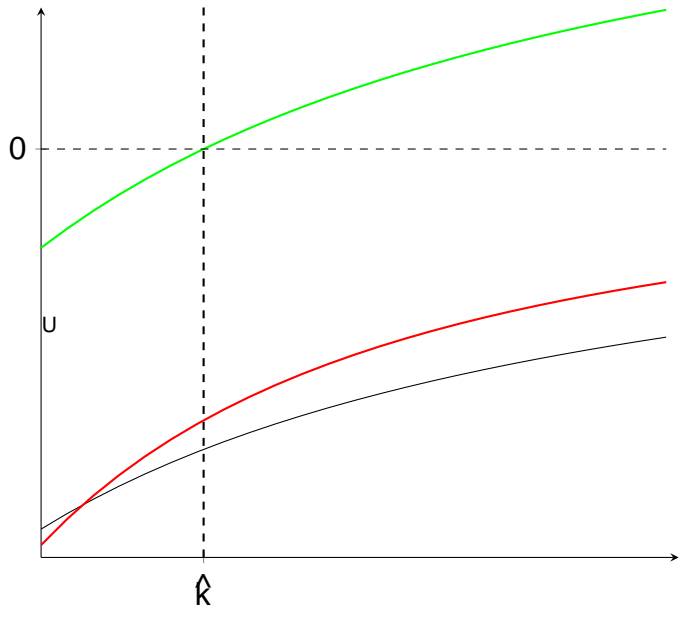
**Lemma 5.** In the setting with accounting manipulation and assessment nondisclosure, it is optimal

<sup>11</sup> It is worth noting that  $k < \hat{k}$  is a sufficient condition for the firm to not tell. The necessary and sufficient condition is outlined in Equation (25). We define this necessary and sufficient threshold cost of manipulation to be  $\hat{k}$ .

for the firm to screen if  $c < \hat{c}$ .<sup>12</sup>

$$c < \hat{c} \iff U_{F;m}^{S;nD} > U_{F;m}^{nS} = 0$$

The intuition for the above result is as follows. If the cost of effort  $c$  is bounded above (that is, if exerting effort is cheap enough), the employee exerts enough effort even with manipulation such that the total output exceeds 0. However, if the cost of effort gets sufficiently high, it is no longer optimal for the firm to conduct the screening test. This is because the employee reduces her effort, which leads to a higher expected manipulation level and an increased cost to the firm of inefficient resource allocation (since the 'wrong' employee is promoted). In this case, we have a trivial reason



parameters.

## 5.1 No Manipulation

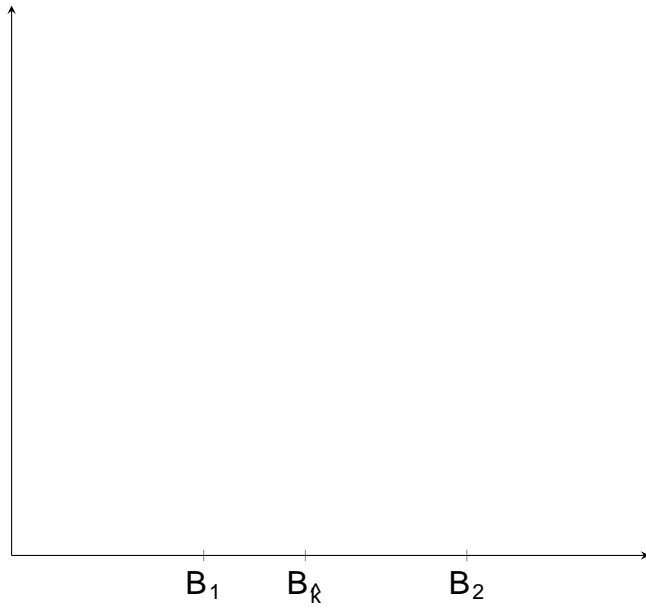
Without manipulation, the employee's effort is increasing in the attractiveness of the promotion independent of disclosure. Given a higher benefit

Taking the first derivative of the employee's effort, we obtain:

$$\frac{\partial \pi}{\partial B} = \frac{s}{2(s)^2(B)} \frac{\partial \pi}{\partial B} = \frac{s}{2(s)^2(B)} \frac{\partial \pi}{\partial B} \quad (30)$$

Direct Effect ND

Indirect Effect ND







## 7 Conclusion

In this paper, we explain why some employers do not disclose assessments to employees. Popular managerial guidance books and consulting firms argue that disclosing assessments leads to increased engagement and effort from high-potential employees, which boosts profits. In our setting without accounting manipulation, we replicate this advice. We show that without accounting manipulation, disclosing the assessment leads to higher profits since the high-potential employee works harder. However, our novel insight shows that when the accounting system is sufficiently weak, and the employee can manipulate the accounting system, disclosing the assessment can decrease expected profits. This is because disclosure of the assessment creates a perverse incentive for the high-potential employee to succeed either through effort or through accounting manipulation. If the accounting system is weak, the high-potential employee chooses to succeed through accounting manipulation, which leads to decreased expected output and wasteful resource allocation for the employer. The decreased outputs and inefficient resource allocation reduce the employer's profit. Thus, the employer chooses not to disclose the assessment. Our model provides some testable implications regarding the relationship between an employer's disclosure of assessments and the strength of the employer's internal accounting system. Specifically, our model predicts that an employer with a weaker (stronger) internal accounting system is less (more) likely to disclose employee assessments. We encourage future research to test our theory.

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# Appendix

Proof of Proposition 3

We solve the inequalities:

$$\frac{\partial \hat{\pi}}{\partial B} = \frac{s}{c} \frac{2(s)^2(B)}{ck} > 0 \Rightarrow k > 2s(B) \quad (33)$$

and:

$$\frac{\partial \hat{\pi}_{H,m}}{\partial B} = \frac{1}{c} \frac{2(B)}{ck} > 0 \Rightarrow k > 2(B) \quad (34)$$

This proves parts (1) and (2). Part (3) is proved below.

$$\hat{k} = (B)(1+s) < (B)(1+1) = 2(B) \quad (35)$$

This proves the upper bound on  $\hat{k}$ .

$$\begin{aligned} \hat{k} &= (B)(1+s) > (B)(2s) \\ \Rightarrow 1 &> s \end{aligned} \quad (36)$$

which proves the lower bound on  $\hat{k}$ . The proof is completed by applying parts (1) and (2). ■

Proof of Proposition 4

(36) 15

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