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An Inside or an Outside Job? How Organizations Use the Information and Attributes of Internal Versus External Job Candidates to Fill Specific Jobs

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An Inside or an Outside Job? How Organizations Use the Information and Attributes of Internal Versus External Job Candidates to Fill Specific Jobs

Abstract

Key Findings

- Firm-specific skills, or those skills acquired through working at a specific organization, are often necessary for succeeding at certain jobs; and internal employees possess higher levels of these skills than do people outside the firm. But, managers either fail to recognize the importance of firm-specific skills or discount their importance, as managers are just as likely to fill jobs requiring high levels of firm-specific skills with external hires as they are with internal candidates.
- Organizations frequently hire "star performers" into jobs where they are unable to demonstrate their superior performance.
- For some jobs, particularly those with many junior positions per senior position, managers have a strong mandate to fill those jobs internally rather than hire from outside.
- Some managers are aware that routinely selecting external rather than internal candidates for certain jobs can degrade employees' morale, and tend to fill these positions internally rather than externally.
- Jobs in which specific employees are able to exhibit a wider range of performance quality tend to be filled more by internally promoted or transferred workers, rather than by external hires.

Keywords

hiring, internal candidates, external candidates

Disciplines

Human Resources Management

Comments

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Key Findings

- Firm-specific skills, or those skills acquired through working at a specific organization, are often necessary for succeeding at certain jobs; and internal employees possess higher levels of these skills than do people outside the firm. But, managers either fail to recognize the importance of firm-specific skills or discount their importance, as managers are just as likely to fill jobs requiring high levels of firm-specific skills with external hires as they are with internal candidates.

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- When deciding between hiring an external prospect or promoting or transferring a current employee, managers weight a variety of factors, including the importance of the employee possessing skills specific to the firm, the certainty with which his or her performance can be predicted and how their decision will affect the motivation of current employees.

Topic: When Does it Make Sense to Fill a Job with an Internal or External Candidate?

Filling jobs at all levels with external candidates has become a common practice over recent years in many organizations. Previously, hiring was assumed to happen at lower, "entry" levels, but now competes directly with promotion and transfer at all levels. The current study looks at a number of factors that can be relevant to the decision to fill a given job with either an internal or an external candidate.

The Past and Present of Talent Management

When looking at an internal candidate, a manager typically has more information about the individual's past performance within the organization, and a better idea of the person's fit with the organization, than about an external candidate. The extent to which managers have this information available is called **information impactedness**.

Some jobs have more **performance variability** than others – the extent to which an individual's personal abilities determine his or her success within the job. Managers have more information about internal candidates' past performance in the organization, and no such information about external candidates. They have a higher level of certainty, and thus, better predictive power about an internal versus external candidate's future performance in a given job. This certainty about a specific individual's performance can be more important in jobs with greater performance variability, since the individual has more latitude to perform better (or worse).

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In addition, internal candidates have higher levels of **firm-specific skills**, such as the ability to use technology specific to the organization and knowledge of in-house procedures, structures and relationships, as well as relevant relationships within the organization.

Another relevant factor is the **grade ratio**, or the number of junior positions directly below a senior position. When the grade ratio is high (i.e., more junior workers per senior position), there are more internal candidates potentially eligible for the same senior position, which means that managers have a larger pool of internal candidates from which to choose. Thus, failure to promote to these positions from within means that more junior workers are passed over for promotion in favor of an external candidate. The organization can pay a high toll in morale if workers see that individuals are hired from outside for these positions, rather than internal candidates being promoted.

External candidates, for their part, offer certain advantages that may be relevant to an organization's specific needs, such as the new hires' outside experiences and practices, and sometimes even their relationships with their former employers. An important consideration to keep in mind is that outside hires are paid much more than are promoted or transferred employees.

In terms of organizational support systems most relevant to internal versus external hires, internally filling a position is supported by the training and evaluation systems. External hires tend to be supported by the practices of attracting, selecting, and socializing new workers.

The extent of information impactedness, the relevance of firm-specific skills, and the performance variability of each job can be important determinants of whether internal versus external candidates are more likely to succeed at the job. While past researchers have studied each of these factors, not much research has been done on how organizations use them to decide whether to hire externally or promote or transfer from within. The current study presents the first job-level study of how organizations use these factors in their decision to source jobs internally or externally.

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Study Questions

- For jobs requiring higher levels of firm-specific skills, do managers prefer to promote or transfer internal employees rather than hiring from outside?
- For jobs with a large range of performance variability, do managers prefer internal or external candidates?
- When a job has a higher grade ratio, do managers tend to promote or transfer within the organization, rather than hire?
- In jobs with higher grade ratios, do organizations have strong mandates to fill these jobs internally or externally, to the extent of possibly not even considering external candidates?

The Results

- For jobs in which firm-specific skills are important, the researchers found that managers do not select internal candidates more than external candidates.
- For jobs with high performance variability, managers tend to fill positions internally more than externally.
- Managers often choose to fill jobs with high grade ratios internally rather than externally.
- For higher-grade ratio jobs, organizations often systematically stress filling the positions with transferred or promoted workers, to the point of excluding external hires.

Factors Affecting Organizations' Decisions to Fill Jobs Internally or Externally

For some jobs, a worker's level of firm-specific skills can significantly affect performance quality. However, managers often discount the importance of firm-relevant skills and knowledge, assuming that a prospect's level of generalized abilities and knowledge is the major determining factor in predicting future performance, and that the individual is ready to contribute immediately upon stepping onto the premises. In some cases, however, knowledge of organizational procedures and processes can be crucial to a worker's ability to do a job, and an employee's possession of firm-specific skills can significantly affect performance.

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Internal candidates have higher levels of firm-specific skills by virtue of their experience within the organization. Accordingly, promotees tend to perform significantly better in these jobs than their externally hired counterparts. Contrary to their hypothesis, however, in the current study the researchers found that managers do *not* prefer to select internal candidates for jobs in which firm-specific skills are crucial. This may indicate that managers underweight the value of firm-specific skills acquired in house.

Reducing Uncertainty For Workers in Performance Variable Jobs

In some jobs, workers' performance is constrained by technology, procedures, or organizational relationships, such that all workers tend to produce a similar level of performance quality. In other jobs, some workers perform much better than others.

A manager strives to evaluate a prospect's suitability for a given job in his or her organization, to anticipate the candidate's level of performance in that job. For internal candidates, managers have much more performance information and thus more predictive power about how these individuals will perform in a given job than they have for external candidates. The researchers found in this study that managers do, in fact, prefer to promote or transfer internally into jobs with high performance variability.

The preference of internal candidates for high-performance-variability jobs can have a significant effect on the overall organization, for a couple of reasons. Whether a job is filled internally or externally can strongly affect the quality of the performance produced in the job, which can in turn make a difference in the organization's overall performance. In addition, since external hires are typically paid much more than internally promoted or transferred employees, the decision to hire versus promote can affect an organization's bottom line – especially if higher-paid employees turn in performance inferior to that of internally sourced workers.

And, if an individual is hired into a job with low performance variability, then the organization may have paid a premium for an individual who can generate superior performance under some conditions, but is unable to do so in his or her new job because of the job constraints. Accordingly, the investment in a "star performer" may fail to yield commensurate returns.

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Promotion's Effects on Morale and Organizational Decision Making

An organization may also pay in terms of existing employee morale if jobs are typically filled externally: If employees see little prospect of being promoted, they can suffer eroding morale and even higher turnover.

With that said, in some positions with high grade ratios, organizations exert strong pressure to fill jobs internally – to the extent that managers systematically do not even consider external candidates. For senior positions with a high grade ratio, managers may have a relatively large pool of candidates available internally. An organization's practice of routinely filling these jobs internally can help boost employee morale, although at the same time may mean that managers pass up promising external candidates.

The Takeaway

Organizations should carefully observe their own patterns of hiring and promoting, considering which jobs tend to be filled externally or internally, and how workers are performing in these jobs, based on whether they entered the position from inside or outside the firm.

Managers should examine their reasons for filling a job with an external candidate versus a promoted or transferred internal employee. If the organization wishes to bring in an external hire to profit from his or her external knowledge, especially if the individual is expected to make a big difference in the organization, managers should ensure that the job will allow the hire to perform well and have the opportunity to make a difference.

Managers should keep in mind that hiring, promoting, and transferring decisions have a spillover effect on employee morale.

Organizations should be aware that candidates from within the organization typically perform better in jobs requiring firm-specific skills.

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If a job has a high requirement for firm-specific skills, managers should recall that bringing in external hires for the job will require a higher investment in time and money to become acclimated and productive.

Managers should consider the specifics of each open position, and what, beyond general skills and abilities, the position requires for an individual to succeed: relationship building inside or outside the firm, a long tenure with the team, knowledge of the firm's processes, experience with proprietary systems within the organization, and so forth.

Data Source

For this study, the researchers used seven years' worth of human-resources records from a single investment-banking firm. The source organization was chosen to represent the financial-services industry, in which workers are notoriously mobile and human capital is a critical asset. The researchers looked at all employees, including administrative and investment professionals, grouped into 19 occupations based around trading, sales, research analysis, and corporate advisory, and ranked on a scale of 1 to 6 from entry level (1) to senior executive (6).

All positions could be filled externally or internally, except the entry-level jobs, which could not be filled by promotion. Over the entire seven years, 236 unique jobs were observed; in a single year, the organization had between 159 to 185 jobs. In total, the researchers looked at 7,749 position-year observations of 5,773 workers in 236 jobs. There were 4,222 promotions, 2,132 external hires, and 1,395 transfers.

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Table 1: Predicted Probability of Promotion, Hiring and Transfer

Results – Effect Sizes

	Predicted probability of PROMOTION at selected levels of the IV				
Variable	Mean	Mean - 1 standard deviation	Mean +1 standard deviation	Δ	% change in rate of promotion
Bonus variability	54.45%	51.93%	56.87%	4.94%	9.51%
Contribution variability	54.55%	51.54%	57.52%	5.98%	11.60%
Structural supply ratio	54.50%	47.82%	60.91%	13.09%	27.37%

	Predicted probability of HIRING at selected levels of the IV				
Variable	Mean	Mean - 1 standard deviation	Mean +1 standard deviation	Δ	% change in rate of hiring
Bonus variability	27.46%	30.29%	24.78%	-5.51%	-18.20%
Contribution variability	27.51%	29.44%	25.60%	-3.84%	-13.05%
Structural supply ratio	27.50%	29.60%	25.05%	-2.45%	-8.90%

	Predicted probability of TRANSFER at selected levels of the IV				
Variable	Mean	Mean - 1 standard deviation	Mean +1 standard deviation	Δ	% change in rate of hiring
Bonus variability	18.09%	17.77%	18.35%	0.58%	3.24%
Contribution variability	17.95%	19.02%	16.88%	-2.13%	-11.22%
Structural supply ratio	18.00%	22.58%	14.04%	-3.95%	-21.96%

Table 1 shows that all variables significantly increase the probability of promotion while decreasing the probability of hiring. The effect on transfers is mixed, though this and other analyses the researchers ran suggest that transfers tend to look more like hiring than promotion.

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For an in-depth discussion of this topic, see: "Within or without? How firms combine internal and external labor markets to fill jobs," *Academy of Management Journal*, 57(5):1035-1055.

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