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# How Do We Create a Robust Internal Labor Market so that Employees can Move Freely into New Roles?

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# How Do We Create a Robust Internal Labor Market so that Employees can Move Freely into New Roles?

## **Abstract**

The success of an internal labor market (ILM) is predicated on the successful communication of stakeholder benefits. One of the benefits of an ILM include higher assessed performance in the first two years among internal promotions and transfers compared to external hires relative to both objective (i.e. sales) and subjective measures (i.e. supervisor performance ratings). Firm-specific skills provide the initial advantage to the internal mover over the external hire, and as the external hire acquires that knowledge the gap in performance is narrowed. Another benefit of a robust ILM is financial. Companies stand to save money over ~7 years because the salaries of internally promoted workers were found to be significantly less (18%) than externally hired employees. Therefore, in order to maximize the value of a firm's human capital the firm should employ processes and tools in service of retaining and developing its internal talent in preparation for promotion and internal transfer, rather than shoulder the costs of hiring externally. In cases where firms routinely hire externally, managers report an observable drop in employee morale.

## **Keywords**

human resources, internal labor market, retention, ILM, stakeholder, external hires, internal hires, promotion, internal transfer, morale, culture, transparency, internal mobility, training, mentorship, employee engagement, HRM tools, analytics, data, conflict resolution, sourcing, selection, culture fit, inclusion

## **Comments**

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## EXECUTIVE SUMMARY

### ORIGINAL QUESTIONS

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How do we create a robust internal labor market so that employees can move freely into new roles? What can we do to encourage movement internally as a retention tool and ensure we have the right people in the right job?

### INTRODUCTION & BENEFITS OF INTERNAL LABOR MARKET

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The success of an internal labor market (ILM) is predicated on the successful communication of stakeholder benefits. One of the benefits of an ILM include higher assessed performance in the first two years among internal promotions and transfers compared to external hires relative to both objective (i.e. sales) and subjective measures (i.e. supervisor performance ratings)<sup>i</sup>. Firm-specific skills provide the initial advantage to the internal mover over the external hire, and as the external hire acquires that knowledge the gap in performance is narrowed. Another benefit of a robust ILM is financial. Companies stand to save money over ~7 years because the salaries of internally promoted workers were found to be significantly less (18%) than externally hired employees.<sup>ii</sup> Therefore, in order to maximize the value of a firm's human capital the firm should employ processes and tools in service of retaining and developing its internal talent in preparation for promotion and internal transfer, rather than shoulder the costs of hiring externally. In cases where firms routinely hire externally, managers report an observable drop in employee morale<sup>iii</sup>.

### COMPONENTS OF BUILDING INTERNAL LABOR MARKET

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Since 1990, large corporations have liberated their ILMs. The traditional managed moves system, in which the employees' career path was determined by managerial discretion has been replaced by job opportunity systems in which employees are free to post for and move to new vacant positions. To design an effective ILM requires three elements: *understanding what the potential conflicts of interests are; designing a process that resolves conflicts; and communicating and alleviating employees concerns*<sup>iv</sup>. There are two levels of conflict that arise in a free ILM<sup>v</sup>

- *Level 1 types*: conflicts are between three different categories of employees, such as employees and line managers, line managers and HR personnel, HR personnel and employees.
- *Level 2 types*: conflicts occur within each category, such as current managers and hiring managers, younger and senior employees, divisional HR personnel, etc<sup>vi</sup>.

On both levels, conflicts of interest arise because of misalignment of the incentives between the different employees<sup>vii</sup>. There are many components to mitigate the conflicts in building a robust internal labor market. These include:

- ***Cultivate culture*** - Companies should ensure a clear understanding by all involved parties that formal restrictions on employee mobility are ineffective when building a supportive and trusting internally mobile culture within companies<sup>viii</sup>. In this setting, HR has become key, providing guidance, counsel, support and other services to employees and managers to resolve conflicts. HR, mentors and managers must engage with employees to plan their career goals and encourage continuous discussion and coaching<sup>ix</sup>. Residency policy can be enforced as a norm or an informal agreement and shared culture. One has to stay in a position for some years and those who do not follow the agreement develop a reputation for this type of behavior, thereby adversely affecting their future employment opportunities.
- ***Build transparent internal mobility process***: Workforce planning coupled with personal development plans allow a firm to clearly communicate its anticipated needs and how employees can act in preparation to fill those needs<sup>x</sup>.
- ***Provide firm-specific education and trainings***: Professional development opportunities should be as firm specific as possible (non-firm specific training and development has been linked to higher attrition rates) and targeted, addressing the firm's anticipated gaps in skill availability and skill requirement based on workforce planning<sup>xi xii</sup>.
- ***Leverage HRM tools***: Accurate prediction of a firm's workforce requirements is dependent upon the availability of qualitative and quantitative data with sufficient depth and breadth to support both descriptive

and predictive analysis<sup>xiii</sup>. The exact depth and scale of data required for each firm may vary. There are currently a wide range of software packages available that help firms source candidates. In addition to managing applicant databases and the hiring process, some applications can now aggregate data to create a blended candidate base that includes both internal and external candidates.

## CASE STUDIES

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- 1) **Chubb:** The company adopts informal processes embedded in an environment of trust and cooperation to design their ILM system. It eliminated its residency policy and its requirement for managerial approval of application for internal positions. Employees are encouraged to communicate career goals and position dissatisfaction openly with their supervisors. Accordingly, supervisors are encouraged to help employees willing to leave their departments to find more suitable positions, thus preventing employees from migrating to another company. HR is key to help resolve conflicts, prevent employee dissatisfaction with improper-fitting positions, facilitate employee transfer. Moreover, HR plays an important role in development and maintenance of the career Web site aspect of Chubb Net. The career Web site communicates and educates to policies, change to policies, and open positions. Employees are led through a series of interactive pages designed to help and to educate them at each step of the process. Chubb's efforts to help its employees understand and clearly see the process lead to enhanced trust in the system and employees' support for it<sup>xiv</sup>.
- 2) **Bear Stearns:** The company institutionalized formal processes and procedures and clearly outlines them in the organizational chart and decision system. The highlight of its ILM practice is its formal conflict resolution process. Conflicts stem from the root of the move, either employee-initiated or manager-initiated. Bear Stearns creates a process management office, dedicated to facilitating job transitions<sup>xv</sup>. Accordingly, one of its main functions is to govern the conflict-resolution process when conflicts arise due to moves. First, the conflict is brought to the attention of the process management office. The office evaluates the conflict, specifically to determine the urgency, the stakeholders, and a strategy to resolve the conflict. If the conflict remains unsolved, business-based arguments are presented to a steering committee, who may arbitrate the conflict or send the issues to the appropriate C-level executive. Throughout the process and at the resolution of the conflict, the office logs the results of each step and notifies all owners and stakeholders of the results and resolution<sup>xvi</sup>.

## BEST PRACTICES

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- *Job design* Jobs that allow workers to contribute quality over a broad range of perceivable criteria are more likely to employ firm specific knowledge and to be filled by an internal candidate<sup>xvii</sup>.
- *Sourcing* When sourcing candidates for current or anticipated openings, firms should ensure candidates are sourced from both internal and external pools. Social networks, employee resource groups, internal and external job posting, and technology solutions should be engaged in the pursuit of candidates<sup>xviii</sup>.
- *Selection* When considering candidates for positions managers should consider what firm specific skills will contribute to the subjective and objective measures of job performance. Moreover, hiring managers, recruiters, and human resources managers should anticipate the effects the hiring decision on employee morale<sup>xix</sup>.

## CONCLUSION & RECOMMENDATIONS

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Drawing on theories of specific skills, a robust internal labor market has clear business benefits such as culture fit, improving morale, lowered labor cost and facilitation of a succession plan. To build a practical and comprehensive internal mobility system, companies should cultivate an open and inclusive culture for internal labor mobility, remove obstacles to transfers and promotions, optimize transparency and standardization in hiring systems, as well as leverage internal and external hiring tools to facilitate transfers.

## Appendixes

Fig1. (Bidwell, 2011)

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%

ig 2 (Bidwell, 2011)

**Table 1. Summary Statistics for Key Variables\***

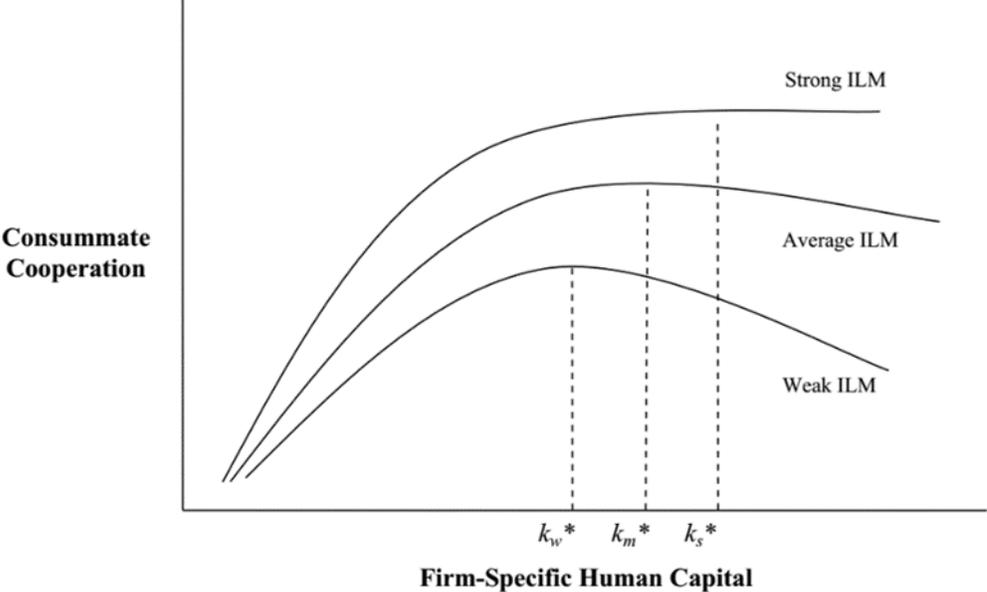
Variable	Mean	S.D.	1	2	3	4	5	6	7	8	9
1. Simple promotion	.55	.50									
2. Promotion/transfer	.03	.18	-.20								
3. Simple transfer	.10	.30	-.37	-.06							
4. Experience	14.82	6.90	-.12	-.07	.13						
5. Highest Bachelor's	.53	.50	.08	.03	.02	-.08					
6. Highest Master's	.37	.48	-.04	-.03	-.02	.02	-.81				
7. Highest Ph.D.	.08	.27	-.08	-.01	-.01	.02	-.31	-.23			
8. Ranked performance	3.74	1.35	.08	-.01	-.04	-.15	.03	-.03	.01		
9. Contribution	3.72	.65	.12	0	-.03	-.08	.01	0	-.01	.56	
10. Competence	3.71	.70	.07	.01	-.04	-.13	-.01	.01	.01	.52	.54
11. Log total compensation	12.56	.88	.03	-.04	-.05	.12	-.13	.11	.06	.18	.22
12. Log bonus	10.74	3.60	.05	0	-.04	-.04	-.06	.05	.05	.16	.2
13. Log salary	11.72	.26	-.19	-.07	.05	.43	-.19	.12	.15	.06	.05
14. Time in job	1.76	1.14	.13	-.01	-.15	.24	0	.01	-.01	.09	.08
15. Year	2007	1.76	-.02	.04	.08	.11	.02	-.01	-.02	.04	.01
16. Rank	3.02	.98	.06	-.04	.01	.41	-.12	.09	.09	.03	.08
17. Male	.77	.42	-.02	-.01	-.01	.01	-.04	.05	-.02	.02	0
18. White	.78	.41	.06	0	.02	.14	.09	-.09	-.02	.04	.04
19. Asian	.16	.37	-.05	0	-.03	-.14	-.1	.1	.02	-.03	-.02

Variable	10	11	12	13	14	15	16	17	18
11. Log total compensation	.24								
12. Log bonus	.2	.63							
13. Log salary	.02	.62	.21						
14. Time in job	.05	.09	-.05	.19					
15. Year	-.04	-.17	-.33	.18	.26				
16. Rank	.04	.68	.27	.81	.14	.03			
17. Male	.03	.22	.08	.17	-.01	-.05	.14		
18. White	.04	.13	.1	.11	.07	-.07	.2	.04	
19. Asian	-.02	-.11	-.08	-.07	-.06	.07	-.17	-.04	-.84

\* Unit of analysis is a year spent in a job. Each observation contains pay in that year and most recent performance evaluation.

Fig. 3 (Lee, 2015)



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- <sup>i</sup> (Bidwell, 2011)
- <sup>ii</sup> (Bidwell, 2011)
- <sup>iii</sup> (JR Keller, 2015)
- <sup>iv</sup> (Hsu, 2002)
- <sup>v</sup> (Hsu, 2002)
- <sup>vi</sup> (Lee, 2015)
- <sup>vii</sup> (Arthur, 1991)
- <sup>viii</sup> (Stack, 2012)
- <sup>ix</sup> (SABA, 2015)
- <sup>x</sup> (JR Keller, 2015)
- <sup>xi</sup> (Elda Pema, 2012)
- <sup>xii</sup> (JR Keller, 2015)
- <sup>xiii</sup> (Stack, 2012)
- <sup>xiv</sup> (Lee, 2015)
- <sup>xv</sup> (Nikos Bozionelos, 2011)
- <sup>xvi</sup> (Jeong-Yeon Lee, 2016)
- <sup>xvii</sup> (JR Keller, 2015)
- <sup>xviii</sup> (Lovell, 2014)
- <sup>xix</sup> (Sharon Belenzon, 2016)