INTERNAL LABOUR MARKETS – THE CURRENT DEBATE AND A THEORETICAL FRAMEWORK

Dr. Carol Royal
School of Industrial Relations and Organisational Behaviour
The University of New South Wales
Sydney, NSW 2052
Australia

Abstract

This thesis investigates the continuing significance of the internal labour market construct for shaping human resource management practices in an international investment banking organisation. By adopting a historical perspective this study departs from existing literature and presents new explanations for understanding internal labour market theory. It also adds to existing scholarship on labour markets by considering more human resources indicators than have been previously used to differentiate labour market types.

The theoretical framework elaborated has two dimensions. The first involves a model which highlights the importance of the organisational historical context for analysing the origins and functions of internal labour markets. It draws attention to certain recurring interrelated features that ultimately result in the adoption of internalised market arrangements. This aspect of the model also highlights the importance of emerging patterns in internal labour market structures that becomes evident over time. The second part of the framework involves a typology that establishes the existence of three different labour market types.

It was concluded that despite the claim made by various scholars that internal labour market arrangements are in decline, the dramatic changes experienced by many organisations have proven that these arrangements are very resilient.

Introduction

The focus of this research and the central thrust of this paper is to determine how significant the internal labour market construct is for analysing the human resource practices and policies in organisations.

Internal labour markets refer to the institutional rules and procedures, such as recruitment, training and the price of labour, which govern the employment relationship (Doeringer and Piore, 1971: 1–2; Althauser and Kalleberg, 1981: 121) in contrast to the external labour market, where such decisions are controlled directly by economic variables (Doeringer and Piore, 1971: 1–2). Scholars have shared
a keen interest in understanding the origins and functions of internal labour markets and to some extent in differentiating internal labour market types. Osterman (1984a: 19) suggests that this interest centred around the argument that traditionally many workers have spent most of their careers with a single enterprise. On this basis, the employment relationship for most individuals has been an important organisational tie that goes beyond a simple market transaction. Organisations themselves may have encouraged this tie by provoking a concept of membership, and in doing so made it very difficult for themselves or their employees to act simply ‘as one party in a straightforward economic exchange’ (Bridges and Villemez, 1994: 177). Whilst organisations may alter the emphasis given to managing internally, the internal labour market construct still continues to be a useful way for scholars to understand how an organisation manages the diversity of its internal labour arrangements.

Osterman (1994a) states that ‘ILMs [internal labour markets] provide a fruitful research arena for a variety of disciplines and intellectual perspectives’ The internal labour market construct is also one of the most useful ways for scholars to understand trends in employment practices because internal labour markets continue to be a very relevant characteristic of modern employment practices. The internal labour market represents, as Osterman (1984a: 19) states, a ‘structured pattern of interaction or behaviour that persists over time and which is subject to changes’. This, Osterman (1984a: 19) says, poses an intellectual challenge. The challenge is extended when the internal labour market’s efficiency benefits have raised discussions about why Japanese organisations are outperforming their American counterparts (Baron, Davis-Blake and Bielby, 1986: 248).

This paper highlights the importance of an integrated approach for understanding the origins and functions of internal labour markets. The approach serves to direct the theoretical focus away from the exclusive emphasis on economic explanations, human capital (institutional), transaction and radical approaches, towards an integrated model. This kind of model emphasises a range of interrelated elements, including external and internal causal factors, managerial perceptions and beliefs, and management strategies. It is precisely because of such interrelationships that an integrated approach is necessary instead of the single factor criterion evident in the economic, human capital, transaction and radical approaches. However, discussion in the latter part of the paper indicates that given the nature and degree of change experienced by many organisations, and in particular the organisation pertaining to this case study, it is difficult for the models of other internal labour market scholars to isolate causal factors in order to explain the origins and functions of internal labour markets. This is further complicated by the failure of internal labour market models to take organisational history into account. It is strongly argued in this paper that the inclusion of an organisational history needs to be considered because it provides a way of identifying patterns among internal labour markets. As Bills (1987: 202) points out, it is critical to differentiate between internal labour market types. He highlights that scholars’ research of internal labour markets has also been hindered by the

---

1 For further discussion of this, see below, ‘The Other Side of the Debate’, page 12.
lack of detailed material describing the economic and organizational dimensions of their design and implementation, and by the neglect of managerial perceptions of the motivations for constructing internal labour markets.

Once again, a historical component is very relevant to the process of establishing the existence of an internal labour market and in differentiating between internal labour market types.

Whilst there has been much theorising by scholars as to how internal labour markets function and why organisations differ in their reliance on internal labour markets, very little is known about different internal labour market types and how they operate in practice. That is to say, a fair degree of uncertainty still remains as to how well scholars’ descriptions correspond to actual organisations.

This paper forms part of a detailed study in the investment banking industry which aims to close some of these gaps. It does this by differentiating internal labour market types in a specific work organisation. The paper is divided into five sections. The first section considers the rationale behind the internal labour market paradigm. The second section centres on the flexible firm model and its links with the internal labour market construct. The third and fourth sections analyse the current debate about the relevance of the internal labour market in future labour arrangements. The fifth section considers in more detail issues pertaining to the origins and functions of internal labour markets and elaborates a typology for distinguishing different internal labour market types. Finally, the sixth section presents a new model of the origins and functions of internal labour markets and an expanded typology of labour markets.

**Internal labour markets and economic theory**

According to Cappelli (1995: 564) and Jacoby (1984: 23), market-based arrangements are not new; they dominated the United States for most of the 1800s and early 1900s, and are drawn from factory work in the United States before 1915. These gave way to bureaucratic arrangements ‘where employee management is regulated inside the firm through a series of rules, referred to as internal labour markets’.

Jacoby (1984: 23) describes the development of internal labour markets in detail. He suggests that their origins are part of a historic shift in the principles of employment. He emphasises unionisation and personnel management as factors that ‘impelled and reflected the replacement of a market-oriented, arbitrary and impermanent employment system by one that was more bureaucratic, rule bound and secure’.

Economic theory encompasses a number of basic approaches toward the internal labour market framework. These include the neoclassical, the radical and the institutional perspectives. In general, the most distinguishing feature of economic theory is that institutions such as internal labour markets play no role (Osterman, 1984a: 5). The interaction of supply and demand sets wages and conditions;
institutional arrangements are simply a means for registering and reacting to market forces (Osterman, 1984a: 5).

Although there are some differences, the non-radical economic theorists of internal labour markets (such as the neoclassical approach of Goldberg, 1980; Williamson, 1975; Becker, 1962, and the institutional approach of Doeringer and Piore, 1971) all view the concept of skills as being central. They believe that ‘internal labour markets are likely to be found in organizations to the extent that firm-specific skills, knowledge or training is required’ (Pfeffer and Cohen, 1984: 553). The reason for this, they suggest, is that employees with firm-specific skills as opposed to general skills are more valuable to the organisation, making turnover of such employees costly. Under Williamson’s (1981: 564) transaction cost framework, employers try to avoid employee turnover by making every effort to ‘embed these skills in a protective governance structure’, whilst employees embed continuity into their exchange relations with employers, recognising that their firm-specific skills are not as readily usable in other organisations.

According to Pfeffer and Cohen (1984: 554), nonradical economic theorists such as Williamson (1981), Ouchi (1980) and Doeringer and Piore (1971) emphasise the importance of technological change because ‘ILMs are likely to be found in organisations that experience higher levels of technological change’.

The radical economists such as Braverman (1974) and Edwards (1979), agree with the concept of firm-specific skills and their association with internal labour markets, but they differ in the interpretation. These theorists see firm-specific skills and the use of technology as forming part of a wider strategy of bureaucratic control by employers to obtain worker compliance. Internal labour markets are seen as a particular form of control (Pfeffer and Cohen, 1984: 555). As Doeringer and Piore (1971: 2) put it, internal labour markets have most commonly been defined as ‘the set of administrative rules and procedures governing the pricing allocation of labor within the enterprise’. This definition, the authors believe, made a clear distinction between the internal versus the external labour market, where the latter has ‘pricing, allocating and training decisions directly controlled by economic variables’ (Doeringer and Piore, 1971: 2) and forms the basis of the internal labour market construct.

Osterman (1984a: 12) suggests that the institutional explanation put forward by Doeringer and Piore (1971) is seen by many scholars and practitioners to cover the major points from which an eclectic analysis can be derived. This essentially is built around four factors: skill specificity, on-the-job training, custom (that is, employee expectation of promotion and codified rules) and unionisation. ‘Unionisation is seen to speed up the formal process and it is where internal labour markets are often derived.’
However, Osterman (1987) suggests that neither the institutional model of Doeringer and Piore (1971), nor the radical and other nonradical economic theorists, help to explain the variation and change in contemporary internal labour markets. What, then, is the thrust of Osterman’s internal labour market analysis? Osterman (1984b: 166) implies that it is inappropriate to assume that a given enterprise has one internal labour market when, in reality, most companies have several different internal labour markets each of which operates with different procedures and rules. Doeringer and Piore (1971: 2) also suggest that both the scope and structure of internal labour markets can be expected to vary considerably among industries and occupations.

Different internal labour markets that exist within a single firm have been referred to as employment subsystems. These comprise four main types: industrial, salaried, craft and secondary subsystems. There are also four elements for defining internal labour markets for a set of occupations. These are job classifications and definitions, deployment, job security arrangements and remuneration arrangements. The characteristics of these four elements include most of the choices available to firms in the four types of employment subsystems. In general, firms are not completely free to choose their employment system. However, they are able to examine options available to them and to make a choice from them. They are also able to ‘enlarge the resources available to make these choices’ (Osterman, 1987: 53). Firms have three specific goals concerning their employment systems: cost effectiveness, flexibility and predictability when designing their employment system so that they are confidently able to rely on a qualified labour supply at foreseeable prices (Osterman, 1987: 55).

Whilst each of these goals has different implications for the choices made and whilst there are conflicting objectives, a firm’s ability to choose among the alternative ways of organising is always constrained by the external and internal environments. These constraints include such categories as the physical technology, the social technology, the nature of the labour force and the role of the government (Osterman, 1987: 59).

Osterman’s (1984a, 1984b, 1987, 1994a, 1994b, 1994c) internal labour market framework is particularly significant because his attention to three sets of factors that together determine the direction of human resource management system change presents a comprehensive overview of how human resource management systems evolve. It therefore deserves extensive attention.

The first of Osterman’s four types of employment subsystems is the industrial subsystem. It is usually found in blue-collar manufacturing markets. It is not, however, restricted to blue-collar jobs or even to manufacturing enterprises, although the internal labour market structure in manufacturing is more often than not linked to the establishment. This subsystem can be distinguished by limited entry points, with the main entry point situated at the bottom of the job classification hierarchy. Production jobs are arranged in terms of seniority, with jobs filled by moving up the ladder in line of progression. Entry is responsive to market conditions. Procedures tend to be well defined, with company values
governing job security rules. Training is often provided by the firm, or takes the form of short courses (Doeringer and Piore, 1971: Ch 1; Osterman, 1984b: 166–170; Osterman, 1987: 47–53). The industrial subsystem applies to managerial staff, including managers entering the organisation as trainees or lower-level supervisors who move up the career ladder.

The salaried subsystem is often used to characterise white-collar work, although it is not limited to this kind of work. This model is distinguished by flexible administrative procedures, flexible career paths and job descriptions, personalised remuneration setting and greater commitment to job security. This model, Osterman (1987: 50) suggests, is fairly important since it represents the employment patterns of a large number of workers. Like the industrial model, it does pertain to some blue-collar work, and it seems to be the direction in which management would like to move when reorganising work.

Craft or occupational markets can be contrasted with the internal market structures found in manufacturing. There is a tendency, as Doeringer and Piore (1971: 4) suggest, to centre the structures around the local union and the craft: ‘The union defines the geographical and occupational boundaries.’ The rules governing entry are more rigid than those in manufacturing establishments, and craft markets contain skills that can be used in many work situations. They are more responsive to competitive forces than to internal promotion.

The craft or occupational system worker tends to be more loyal to the craft or profession than to the firm. Managerial or occupational internal labour markets ‘reach across employers, industries, and even geographic areas’ (Althauser and Kalleberg, 1981: 23). There are some well-known examples of white-collar jobs, such as lawyers and computer programmers, that fit into this model (Doeringer and Piore, 1971: Ch 1; Osterman, 1987). Care must be taken, however, when identifying occupational internal labour markets. Many lawyers work in corporations solving legal problems, as opposed to becoming partners in law firms, and in this instance are best described by using a firm internal labour market rather than an occupational internal labour market structure. Wholey (1985: 331) states that ‘it is incorrect to presume that labor markets associated with professionals are occupational internal labour markets’.

The final subsystem is the secondary subsystem. This refers to low-level, low-skilled, poorly paid jobs, with little chance of career progression within or between firms. Employers find this particular subsystem attractive because workers can be used flexibly, and they have relatively little power. These workers are not fully committed and tend to be sporadic (Osterman, 1987: 52).

Hence, it can be seen that Osterman’s (1984a, 1984b, 1987, 1994a, 1994b, 1994c) alternative model for categorising occupational arrangements or employment subsystems helps to improve scholars’ understanding of the ‘internal labour market structures available for organising work and the considerations that lie behind the choices made’ (1987: 67).
The Internal Market Construct and the Flexible Firm Model

Appelbaum and Batt (1994: 9, 13) show from their American workplace innovation study, *The New American Workplace*, that while organisations aspire to become high-performance workplaces, most of them find this difficult to achieve. For those who are moving down that path, the authors’ survey material suggests that there is ‘no one best way emerging’. One strategy for improving workplace performance is encompassed in the Flexible Firm model (Atkinson, 1984) and more specifically the core-periphery arrangement. Before discussing its relevance to the internal labour market framework it is important to touch on the model itself.

In brief, the Flexible Firm model developed by Atkinson at the Institute of Manpower Studies reflects, as Ledwith and Colgan (1996: 145) suggest, tensions between ‘production and versatility strategies’. These strategies require firms to be more adaptable to market changes in terms of price, products, and range and quality of goods and services produced, and more adaptable in terms of labour resources pursued. To do this firms need to apply different types of labour flexibility, often simultaneously. The four main types of flexibility that have attracted the most attention are functional or task flexibility, numerical flexibility, financial or wage flexibility and temporal flexibility.

Function or task flexibility refers to the capacity of employees to undertake a range of tasks or skills. This strategy has, of more recent times, been aligned with value-added strategies. By numerical flexibility, Atkinson (1984: 28) means management’s ability to vary the amount of labour available in response to changes in levels and patterns of demand. Strategies include the use of subcontractors, casuals and other short-term employees who can easily be called upon or dispensed with. This has been aligned with cost reduction strategies. Financial flexibility (Atkinson, 1984: 28; Atkinson and Meager, 1986: 26–29); sometimes also called wage flexibility, refers to the movement towards individualised pay systems which reflect local conditions and are more dependent upon performance. Temporal flexibility (Atkinson and Meager, 1986: 26–29) enables firms to use varying patterns of hours worked in response to changing market conditions and employee needs.

The Flexible Firm model (Atkinson, 1984; Atkinson and Meager, 1986), Ledwith and Colgan (1996: 11, 12) imply, requires employers to seek an optimal balance between the four different types of labour flexibility by segmenting the labour force into core and peripheral groups.

Core workers in organisations perform the organisations’ main activities. Typically, they are functionally flexible, numerically stable, and are usually classified as full-time permanent staff. They enjoy job security and the possibility of career development opportunities in return for being multi-skilled and shielded from market fluctuations by permanent arrangements (Atkinson, 1984: 28, 29; Atkinson and Meager, 1986: 26, 27).
Peripheral workers can be classified into three categories. The first consists of both white or blue-collar workers who are less permanent and who perform relatively routinised or de-skilled tasks which require some firm-specific training but in general offer few career prospects (Atkinson, 1984: 29; Atkinson and Meager, 1986: 26). The second group of peripheral workers comprises those who have specialist, non-firm-specific skills and are used intermittently by organisations. This group provides numerical flexibility. However, their fees are high. They usually include such specialists as computer consultants, programmers and Total Quality Management people (Atkinson, 1984: 29). The last group is usually made up of small subcontracting firms that offer such services as cleaning, catering and the like, and which usually attract temporary unskilled workers who generally receive low wages and experience poor working conditions (Atkinson and Meager, 1986: 29).

The Flexible Firm model has strong links with the internal labour market construct since it suggests that core workers in the primary market enjoy the benefits of internal labour market arrangements, whilst periphery workers in the secondary market do not.

Althauser and Kalleberg (1981), however, suggest that there are ‘inconsistencies between market classifications in the original, broad definition and in the simpler operationalization’. That is to say, not all internal markets are located in the primary market, and secondary market peripheral workers, particularly those in the first category, occasionally ‘enjoy secondary jobs attached to ILMs in various organisations’ (Althauser and Kalleberg, 1981: 128; Doeringer and Piore, 1971: 167–168).

More often than not, however, the dual labour market and its inherent internal labour market arrangements have unfortunate effects on different demographic groups, so that women, ethnic minorities, and younger workers often hold secondary peripheral jobs, whilst the core primary jobs are held by (white) males.

Althauser and Kalleberg (1981: 129) and Kalleberg and Wallace (1981: 79) suggest when groups and markets overlap by definition, it is hard to formulate explanations of theoretical relationships between job markets and the employment of various demographic groups.

There have been a variety of criticisms made of Atkinson’s Flexible Firm model (Pollert, 1987, 1988; Hakim, 1990; Hunter, McGregor, MacInnes and Sproull, 1993; Legge, 1995; Ledwith and Colgan, 1996). Pollert (1987, 1988) and Legge (1995: 168) suggest that the concept is considered to be conceptually flawed, because it is ‘poorly specified and conflates very different changes in work organisation’, making rigorous empirical testing difficult. Hunter, McGregor, MacInnes and Sproull (1993: 383) state that it is ‘rather sterile revolving around a few key papers with an almost infinite variety of interpretations of what the Flexible Firm model was thought to be saying’ and also that it is thought to have been developed in a theoretical vacuum (1989: 130, 131).
Despite this, however, Legge (1995: 170) states that the popularity amongst academics of the flexibility concept and its relation to human resource management can be accounted for because the ‘testing offered a research focus that looked practical, relevant, consistent with government economic policy and hence likely to attract funding’. What academics really need to readdress, according to Legge (1995: 171), is the ‘hard and soft models of HRM’, because gaps exist in the relationship between the realities and rhetoric of flexibility.

The hard model of human resource management makes use of strategies that involve ‘cost control to secure competitive advantage’. These strategies are more likely to result in extensive use of labour market segmentation in the pursuit of financial flexibility or the coercion of core employees to become more functionally flexible. Either way, the hard model implies more ‘labour intensification’ (Legge, 1995: 172).

The soft model, on the other hand, seems to suggest a lack of commitment from core employees due to ‘over-fragmented jobs with little ownership’ (Legge, 1995: 172). Whilst core workers can overcome this to some extent by enhancing job satisfaction with functionally flexible work practices, such as Quality for Work Life (QWL) (Legge, 1995: 172), periphery workers are unlikely to have the same opportunities.

Overall the rhetoric does appeal to practising managers because ‘they get a visual and verbal image that gives access to the inner logic of existing labour market strategies’ (Legge, 1995: 172). She adds that ‘the language, nonetheless, is deceitful, with labour intensification couched in such positive terms as multi-skilling and teamwork and the like’ (1995: 172). But despite the criticism and the debate, certain pressures, such as globalisation, intensified competition, privatisation and deregulation, mean that the concept of the flexible firm still holds meaning for some firms.

Whilst there is perhaps little evidence that the strategic use of the core-periphery model is being adopted by firms (Atkinson and Meager, 1986: 29), tentative moves still constitute use of the core-periphery arrangements. Therefore it is important to note that many firms may keep using ad hoc arrangements, whilst others, as Benson (1995: 604) implies, will continue to adopt the core-periphery model as one of their main strategies for improving organisational performance. By ‘using an internal labour market for the core jobs, firms can rely on the external labour market for all other jobs’. In this way, the firm can adjust ‘the peripheral workforce to meet changes in demand’ (Atkinson, 1984: 29, 31; Atkinson and Meager, 1986: 604).

**Future employment arrangements and the relevance of the internal labour market for scholars**

Being able to predict what ‘the typical work organisation will look like ten or twenty years from now is somewhat difficult to do and in many ways it is too early to tell’ (Abraham and McKersie, 1990: 5). Whilst many scholars have recently documented the changes occurring in the way work is being
organised, particularly in the United States, others (Cappelli, 2000: 6, 1995: 603; Abraham, 1990: 88; Abraham and McKersie, 1990: 5–6; Benson, 1995; Milner, 1995; Morishima, 1995; Osterman, 1994a, 1994b, 1994c) have discussed more specifically the changes in the internal labour market structures currently underway.

Cappelli (2000:67) states that “market-mediated employment relationships” best describe the current practices. In his book *The New Deal at Work* (1999: 5–7) and his paper ‘Rethinking Employment’ (1995: 563) he gives a thorough review of United States evidence on the internal labour market and how changes in work organisation have resulted in a ‘breakdown across many aspects of internal labor markets, even for permanent employees’. His argument (1999: 50) is comprehensive and it is worth considering its key issues. He begins by focusing on market-based arrangements that existed in the United States until the early 1900s, but which were replaced by ‘bureaucratic work rules’ because these allowed for firmer management control and also for demands by various groups, including trade unions and personnel departments, to reform the system. Internalised arrangements also helped to curb the uncertainties of the external labour market. In a sense, the new work rules promoted and developed the internal labour markets where ‘employee loyalty and adequate performance’ were exchanged for ‘security and predictable improvements’ (1995: 565).

Cappelli’s (1995: 563) documentation of evidence on the decline of internal labour markets suggests that in the United States in the 1990s these arrangements for managing employees internally have changed. There is now heavy reliance on outside forces to manage employees. He argues (1999: 5, 110, 181, 182, 244) that

changing markets, increased competition, new management techniques, the declining influence of trade union pressure, the requirements of public policy and new government and employer philosophies have resulted in a return to a more market-based labour system.

From the evidence presented there appears to be some use of new or transformed work practices, such as teams (particularly autonomous and semi-autonomous). There also appears to be less job security for core workers, more job switching, flatter job hierarchies that make entry and career pathing more difficult, and decisions about remuneration and training being determined by the external labour market (Cappelli, 1999: 9–12, 48; 1995: 589).

Whilst some of these could be considered contradictory and may be difficult to resolve, the following emergent trends indicate that, firstly, a paradox exists between teams and work organisation. Cappelli (1995: 591–593) argues that teamwork generally creates team- or firm-specific skills which demand training and are hard to replace, and this assumption has meant that, for the firm, employee attachment is important in order to recoup the cost of such an investment. However the paradox here is that such attachments, he suggests, are weakening, with hard-to-replace skills moving to the external market and, further still, being outsourced completely.
Osterman (1995: 132) argues that firms have overcome this problem of turnover by offering workers wage premiums called ‘efficiency wages’. Only some firms, as Cappelli (1995: 592) implies, would be in a position to do this. Secondly, Cappelli (1995: 592) argues that there is declining attachment to a firm but an increasing attachment to the occupation. This poses training problems. Individuals may wish their employer to provide more training, because the employer will have more time in which to recoup it. The paradox, however, is that the employer may be reluctant, fearing the inability to recoup the investment if an employee leaves too soon. Related to this, Cappelli (1995: 592) says, is the issue that broad-skilled, cross-functional teams make it difficult for unskilled workers to enter an organisation and work their way up. This is the reverse to other forms of work organisation, such as scientific management, where unskilled workers could gain access to entry-level positions and learn as they go, with the opportunity for advancement. This paradox poses the question of how, then, do new entrants develop the skills necessary to work in these teams? Thirdly, the trends indicate a further paradox. Cappelli (1995: 593) implies that there is a decline in employee commitment and work-related attitude without a corresponding decline in employee performance. This raises a series of concerns, especially given that most organisations have used teams to cut back on supervision, which generally implies that more autonomy requires greater employee commitment, not less. Peer group pressure often prevents an employee from letting the side down, and the use of short-term contracts based on performance of the individual or the team is one method that organisations use to overcome declining employee commitment. Cappelli (1999: 221) argues that

> It is not clear that offering lifetime job security will enhance employee commitment by much in the current environment given that opportunities elsewhere in the market are an important source of the erosion of commitment. These opportunities are outside the control of individual employers and are growing.

The logic of Cappelli’s argument, and his evidence discussed in some detail above, seem to correspond to the arguments proposed by Pfeffer and Baron (1988) and Abraham (1990). They assert that there has been ‘a substitution of market-transactions for direct employment relationships including temporary employment and contracting out’ (Abraham, 1990: 86). It also corresponds with the proposition put forward by the core-periphery model in Britain, which represents the changes in employment as a movement towards contingent and contract work (Atkinson, 1984). However, unlike Cappelli’s, none of these other arguments views changes as a breakdown of internalised employment practices (Cappelli, 1999), but rather a shift along a continuum.

Based on the evidence, these changes, according to Cappelli (1999), go beyond the breakdown of the internal labour market structures and the employment relationship. He suggests that some of these trends have serious consequences for society as whole:

> Employees now face greater risks of job loss and income variation, with little offsetting advantages for having business risks forced upon them. For unions, a change in labour relations and the use of enterprise based models relies on greater attachment to an employer
rather than a declining attachment. However, a decrease in attachment to a single employer and a greater norm of mobility between establishments may reduce the interest in union “value” as opposed to the option of “exit” (Cappelli, 1995: 594).

Finally, the possibility of low levels of work-based training that is optimal for society, and the lack of distributive justice, imply that employers are making all the gains from the changes in the employment relationship, with employees, who continue to experience falling wages and job insecurity (both previously buffered by the internal labour markets), feeling increased uncertainty. Cappelli (1999: 244) argues that a ‘summary answer to whether the new deal is a good thing is simply that it is good for efficiency and opportunity and bad for traditional notions of fairness based on concepts of equity’. How employees, unions and society will adjust to this greater uncertainty is yet to be seen (Cappelli, 1995: 594). However, changes in markets, product techniques and other factors will change the employment relationship again. It may cycle back between the poles of internal development and the outside labour market. The challenges of adapting to lifetime employment relationships may come quicker than we think (Cappelli, 1999: 244).

The other side of the debate
Cappelli’s argument, and that of those who think similarly, such as Abraham (1990), represents a reasoned and detailed analysis of current trends in employment practices. However, there is other research evidence put forward by scholars which predicts a totally different outlook for future labour market arrangements within organisations. Scholars have based these arguments on a number of strategies currently being used by firms in an attempt to improve their performance, not all of which have led to a weakening of a firm’s internal labour market structures; in some instances, the evidence suggests a strengthening of such practices.

The National Organizations Study conducted in 1991 by Kalleberg, Knoke, Marsden and Spaeth (1996: 33) specifically aimed to answer questions about the structure, context and personnel practices of companies. The study highlights that, in 772 American organisations across a diverse range of industries, internal labour market arrangements in modern industrial societies are highly significant. Kalleberg et al (1996: 88) argued that firm internal labour markets are integral to theories of stratification with organisations and human resource management because they are contexts wherein many skills are acquired, mobility and career advancement take place, and higher earnings are often attained. Good jobs and good wages are located in firm internal labour markets. In that they offer important positive incentives—particularly employment security, the prospect of rising income, and seniority-related fringe benefits—FILMs create strong ties between workers and employers.

Appelbaum and Berg’s (2000: 117,118) study of 4,000 employees across 39 plants examines modern manufacturing practices in three industries. The study stresses the importance of long-term employment. Despite the difficulty in extracting “such a commitment from the firms”, companies that adopt modern manufacturing practices, such as horizontal coordination, communication, self-directed
and offline teams, contingent pay and group incentives, still promise employment security. By promising employment security, firms find that it helps to build trust amongst workers. Safeguarding long-term continuity in employment requires a protective governance structure.

Appelbaum and Batt (1994: 124) indicate, from their study of nearly 200 cases of workplace change in American firms, that models of high performance ‘frequently involve managers and employees combining practices drawn from very different production models to create a new model they hope will lead to improved efficiency or quality’. As a result, the authors suggest that ‘many US firms put together a menu of human resources policies and organizational tools so that new human resource practices allow for more variety within the organization’.

Appelbaum and Batt’s (1994: 142, 145) review illustrates that one of the American high-performance work systems, involving the use of decentralised self-directed teams referred to by the authors as ‘American team production’, requires for its success new human resource and industrial relations practices that strengthen internal labour market arrangements in firms. The authors state that:

central to the flexibility inherent in these companies’ labor contracts is a strong commitment to employment security. This commitment makes economic sense for firms that have invested heavily in training their workers and where multi-skilling allows for more flexible internal deployment. Employment security also affects how participatory arrangements influence team performance.

Womack, James and Roos (1990: 198), in *The Machine That Changed The World*, similarly reinforce the importance of the internal labour market construct by claiming that whilst a lean production system involves job reclassifications and work reorganisation, ‘[t]he lean enterprise strives to provide every employee with a clear career path’. To achieve this, all employees must work on the production line for some time in order to understand how value is added to the enterprise. Problem solving is fostered for those who remain with the firm and high pay is based on seniority and performance bonuses. Those employees with specialised skills are shifted among different teams, often having to learn completely new skills as their careers progress (Womack, James and Roos, 1990: 199).

Porter (1990: 585–586), in *The Competitive Advantage of Nations*, adds further support for the internal labour market structures in firms by stating that competitive advantage is achieved through people. He argues that firms need to seek out pressures and challenges in order to foster innovation. One of the important ways of doing this, he says, is to treat employees as permanent. This, he believes, helps to ‘upgrade and sustain competitive advantage’. The implication is that new employees need to be hired with caution, so that continuous improvements are made to productivity, rather than simply adding workers from the external labour market. ‘Training is to be on an ongoing basis to support more sophisticated competitive advantages and permanent skilled employees are to be transferred or redeployed rather than laid off.’
Baron, Davis-Blake and Bielby (1986), in their article ‘The Structure of Opportunity: How Promotion Ladders Vary Within and Among Organizations’, focus on internal labour markets in one hundred diverse work organisations to examine why organisations have different opportunity structures. This analysis ‘lends considerable support (at the job level) to perspectives viewing internal labour markets as a response to exigencies of firm specific human capital’. The results also provide support for the view that internal labour markets are a response to characteristics of particular transactions or jobs within an organisation.

Wholey (1985: 319), in his article ‘Determinants of Firm Internal Labour Markets in Large Law Firms’, points to the continuing importance of these arrangements for future success. Interestingly enough, from his research, which involved some 3,000 large law firms in the United States, he concludes that the professional labour market linked to such firms does not show a strong occupational internal labour market component. Large law firms’ internal labour market arrangements resemble those of major corporations, which fill senior positions by using job ladders and promotion up these ladders to train, motivate, assess and retain staff (1985: 331).

The growth in the number of firms, the number of major clients and the addition of major clients has meant that lawyers need to be able to demonstrate their ability to attract clients and ‘to control a critical resource dependency where promotion and client control are more likely to be positively related’ (Wholey, 1985: 318, 333). Understanding the political economy and the resource dependence goes a long way towards understanding the continuing significance of internal labour market arrangements for these organisations.

Starbuck (1993: 892–895) adds to this discussion by examining the success of a top United States law firm, Watchell, Lipton, Rosen and Katz, which differs significantly from other highly successful United States law firms. Watchell was founded in 1965 by four friends and alumni of New York University’s Law School. Relevant statistics taken in the early 1990s show that of the top twenty of America’s largest 100 law firms, Watchell is the smallest. It is also the smallest firm among the largest 100. It has the highest revenue per lawyer, and disproportionately few partners for its size. Finally, its profits total 68.5 per cent of its revenue. No other United States law firm has profits that exceed 52.8 per cent revenue.

Starbuck (1993: 907) suggests that the firm’s exceptional success can be attributed to two facts. Firstly, it is a knowledge-intensive firm that earns its money from specialised expertise. Secondly, it uses internal labour market arrangements and associated human resource management practices and policies to manage its employees internally. Over the years, these practices have created and maintained a distinctive corporate culture.
Each year, the firm receives 1,200 applications from law students. It recruits twenty to twenty-five of these graduates, usually giving preference to those who had summer jobs with the firm (Starbuck, 1993: 902). Watchell’s compensation system is similar to the internal labour market practices in other large corporations, where percentages received are based entirely on seniority.

The firm’s recruiting policy is to offer long-term employment opportunities. The founding partners believe that this internal labour market practice is central to their prolonged success. Research material highlights that in the history of the firm ‘only one person has been brought in as partner. No one is hired that is expected to leave’ (Starbuck, 1993: 903, 907). The staff are considered to be all home grown, so much so that it has proven unsuccessful to locate offices in other parts of the world. The founding and senior partners consider that their ultimate responsibility is on-the-job training of both associates and junior partners. Survey material indicates that subordinates ‘practice in the puddle created by the founding partners’ rain’ (Starbuck, 1993: 912). Given their special formula, Watchell’s founding partners predict, amongst other things, that if these internal labour market practices are upheld by the next generation the firm should continue to enjoy exceptional success. Time, however, will tell.

The current research on Japanese employment practices also adds support for the continuing existence of internal labour market rules within many Japanese firms. Morishima (1995: 620) states that ‘Japanese employment practices are described by a four-factor model, long-term employment, internal training, employee involvement, and evaluation based on ability growth’. Despite the alleged changes in Japanese employment practices, and the current debate suggesting the decline in the United States internal labour market structures, Morishima implies that ‘the overall picture shows an amazing resilience in maintaining the traditional Japanese system of HRM’.

Looking at some of the pillars of Japanese human resource management practices in more detail, Morishima (1995: 620) infers that long-term employment is one of the ‘more noteworthy characteristics of white collar employment’. The practice of recruiting employees from school and their remaining with firms until retirement is, according to Morishima (1995: 621), still strong. Recent Japanese data indicates that whilst white-collar workers in Japan are ‘more likely to stay with one firm than are members of the overall workforce, employment tenure is increasing for both blue and white-collar workers’. This is somewhat contrary to the ‘demise of the permanent employment theme’ (Morishima, 1995: 621).

According to Morishima, the incidence of training in Japanese firms is higher than in the United States and continues to increase. Long-term employment practices in Japan also indicate a commitment by firms to invest in intra-firm training. Given the internal labour market practice of lifetime employment, current data indicates that the firm is not losing its investment, and that more in-house training is occurring than may otherwise have been the case (Morishima, 1995: 621–622).
The employee pay and promotions system is another example of the internal market arrangements that exist in Japanese firms. It is predicated on an employee’s capabilities, which are formed by ‘cumulative on-the-job-experience and internal training, and, therefore, strongly related to tenure’. There are seven to eight skill grades, and it generally takes some two years to perfect each grade. This skill grade system ‘encourages learning over a long span of one’s career’ (Morishima, 1995: 623–624).

The benefits of the traditional Japanese four-factor model of employment practice described by Morishima (1995) and other scholars are not as clear-cut as they may appear. William (1995: 643), in his critique of Morishima’s (1995) data, suggests that the traditional firms may not be reacting to external forces and economic events as much as the small percentage of firms in his data that have moved away from the internal practice of employment security and similar practices. To complete the picture, some discussion over ‘the contextual influences of the traditional firms’ desire to change’ may help in analysing change itself, and help to determine the ‘balance between internal forces and external constraints’.


HR innovations are slowly being diffused, the huge costs associated with the traditional system plus the complex interdependencies between micro and macro institutions could, due to recent recessionary pressures, result in incremental changes that eventually produce a qualitative transformation.

Despite William’s (1995) and Jacoby’s (1995) critique, the vast majority of firms in Morishima’s (1995: 633–635) sample (reflecting some 89 per cent) remain committed to the internal labour market practice of lifetime employment and job security. In many ways, this and the other peculiarities of Japanese employment practices discussed above still, to a large extent, reinforce the continuing importance of the internal labour market structure. Jacoby (1995: 649) admits that ‘Japan is nowhere near the point of a qualitative transformation from the traditional system yet’. Contrary to Cappelli’s argument (1995), by using such internal labour market practices many Japanese firms still enjoy continuing success in maximising the use of their human capital.

Whether the discussion is focused on human resource management policies and practices and the internal labour market arrangements as they pertain to United States firms or those that pertain to Japanese firms, one is not to be deceived into believing that managers are simply free to design such practices as they please. This would oversimplify the internal labour construct. It is important to remember that it is a constrained choice in which managers are not the only actors. Unions are also an integral part of the system and they help to shape both human resource management policies and practices and management values. Choices are also constrained by associated business strategies, external institutions (Morishima, 1995: 617, 637), external pressures (William, 1995: 643), the
political economy and, in the case of law firms, by their clients and competitors as well. This will be discussed further in the next section.

**Internal labour market theorists**

The focus of this section is to highlight in more detail than was previously raised the specific work of some of the important internal labour market theorists. These scholars have addressed either issues pertaining to the origins and functions of internal labour markets or issues which have lent themselves to distinguishing different internal labour market types. An analysis of the models presented by such scholars as Grimshaw and Rubery (1998), Rubery and Wilkinson (1994), Burchell and Rubery (1994) and Bills (1987), and the differing internal labour market features discussed by Pfeffer and Cohen (1984), and more importantly by Althauser and Kalleberg (1981, 1989), are necessary in order to determine their relevance to this case study organisation. Having determined the extent of their relevance, a model of the origins and functions of internal labour market structures and a typology of internal labour markets have been developed, as a framework for analysing this case study.

**The British scholars**

Grimshaw and Rubery (1998), Rubery and Wilkinson (1994) and Burchell and Rubery (1994) explore the existence and function of internal labour markets from a different and somewhat novel perspective. Rubery and Wilkinson (1994: 41) suggest that an appropriate framework for analysing labour market structuring requires:

- firstly a consideration of the incentives to “internalise” labour;
- secondly, an exploration of constraints on employer employment policy; and
- thirdly, an analysis of the interrelationships between employer policy and the external labour market.

The first of these highlights that the incentives for firms to internalise can be divided into three categories: those associated with labour as a factor of production, those associated with the system of competition and those associated with the system of production (Rubery and Wilkinson, 1994: 42).

These two scholars argue that there is a wide range of motives related to labour as a factor of production which have been suggested as reasons why firms may wish to internalise. Some of these are to capture returns on training investment (Williamson, 1975), to unleash productive capacity and improve organisational performance (Storey, 1989; Guest, 1987), to reduce the need for organised labour, and, as earlier literature has implied (Doeringer and Piore, 1971), to provide workers with firm-specific skills to protect them against economic downturn, whilst also encouraging continuity of employment. According to Rubery and Wilkinson (1994: 45), this is a general list rather than one that is confined to particular kinds of organisations.

However, there are other incentives for internalising. Competitive conditions lead employers to strive to internalise areas which are central to their overall effectiveness, while production conditions demand a stable, committed workforce. This suggests a more complex model than “can be adequately
explained by cost or price minimization’ (Rubery and Wilkinson, 1994), particularly in light of the constraints on employment policies and the interrelationship between organisations, employment policies and the external labour market. Firms are not equal and are naturally constrained by financial and organisational characteristics. ‘Fine tuning of a firm’s employment system is somewhat hindered by such costs as management time, training costs, impact on motivation and expectations’ (Rubery and Wilkinson, 1994: 56).

Whilst firms can adopt long-term strategies which go some way to reducing financial and organisational obstacles by targeting the particular labour opportunities of a firm’s workforce (Rubery and Wilkinson, 1994: 56), both scholars highlight the fact that not only are a firm’s internal employment policies influenced by external labour market conditions, but also that interaction is a two-way process whereby the external labour market is also structured by the policies and practices of firms. Institutional factors have as much influence on internal as on external labour markets.

Following on from the earlier work by Rubery and Wilkinson (1994) and building on the work of Osterman (1994a, 1994b, 1994c), Grimshaw and Rubery (1998) have developed a more comprehensive model which incorporates a dynamic analysis of changing patterns in internal labour market structures. This is shown in the figure on the following page.
Grimshaw and Rubery (1998: 213) stress that the general aim of the model is to analyse employment strategies as they are influenced by changing conditions in each of the three rings, by the interaction between the rings, and to identify how changes in employer strategy may potentially feedback on conditions in each of the three rings. In other words, changes that take place in a firm’s internal labour market structure occur as a net result of transformations in each of the three rings shown in the model.

Burchell and Rubery (1994: 351, 352) state that the model in Figure 1.1 must be viewed from both managers’ and employees’ perspectives. The extent to which there is ‘agreement between managers and employees as to what type of employment practices and policies exist within an establishment is an important social and economic phenomenon’. Employer strategies vis-à-vis labour markets require an understanding by management of employees’ perceptions and an ability to deliver outcomes for them.
American scholars Pfeffer and Cohen (1984; 1986) and Bills (1987) have enriched the internal labour market analysis by including other factors besides technocratic and economic explanations of the way in which work is organised. Pfeffer and Cohen (1984: 570; 1986: 19–21) indicate that models which attempt to examine the extent to which internal labour markets are present need to direct the theoretical focus ‘away from an exclusive emphasis on functional, technological requirements and toward organizational processes such as power, influence, institutionalization, conflict and contests for control.’

A more integrated approach, Pfeffer and Cohen (1986: 21) stress, requires an emphasis on organisational arrangements, in particular power and control to account for dimensions of the employment relationship, whereby the focus is directed towards the desires of various organizational interests and their relative ability to enforce their preferences. Such analysis is important in advancing the understanding of these critical organisational features. It also introduces the feasibility of using organisational theories to account for the organisation of the employment relationship.

Bills (1987: 202) has elaborated a model that covers the essential elements of both the British and American features. In his view, much of the research into internal labour markets has been hindered by several factors:

- the failure to differentiate the wide variety of internal labour markets, by accounts of their determinants that too heavily emphasize isolated causal factors, by the lack of detailed material describing the economic and organizational dimensions of their design and implementation, and by the neglect of managerial perceptions and motivations for constructing ILMs.

Bills’ model is presented in the figure on the following page.
Bills’ (1987: 210) model centres on such factors as costs, commitment and rewards. These dimensions are used to assess the interactions of the effects of markets and hierarchies on internal labour markets. The model also highlights the notion of ‘underlying imperatives typically held to affect ILMs inevitably filtered through managerial beliefs and the constraints on managerial and organizational decision makers’.

Bills (1987: 206) indicates that whilst internal labour markets are ‘subject to planned and unanticipated adjustments’ (implying that internal labour markets are ‘adaptive organizational responses to a continually changing environment’), a reasonably concise set of variables covered by the model above can account for the variations. However, Bills (1987: 209) suggests that efforts to construct more refined typologies of internal labour markets should be the goal of future research.

Unlike the approaches adopted by the British and American scholars above, which are predominantly concerned with the origins and functions of internal labour markets, and following on from the earlier
discussion of Osterman’s work (1984a, 1984b), Althauser and Kalleberg (1981; 1989a) stress the importance of a framework that differentiates internal labour market types. In their research Althauser and Kalleberg (1981: 12; 1989a: 151) identify the existence of several types of internal labour markets which they believe are unlikely to have the same origins and consequences, therefore a definition of an internal labour market ‘specifying precisely what all kinds of ILMs have in common and what features are unique to each type’ is required. Like the definitions of Doeringer and Piore (1971) and Osterman (1984a, 1984b), those of Althauser and Kalleberg (1981: 130) state that the three basic structural features that different types of internal labour markets have in common are ‘firstly a job ladder, secondly entry only at the bottom and thirdly movement up the ladder, which is associated with a progressive development of knowledge or skill’. If there is a lack of one of the three basic characteristics then it is considered to be an external labour market or an occupational labour market.

Althauser and Kalleberg (1981: 130) importantly distinguished two types of internal labour markets. The first of these is a firm internal labour market (FILM) and the other is an occupational internal labour market (OILM). Both share the three structural features; however, ‘they operate in distinctive ways that reflect their fundamental difference: FILMs are controlled by employers, whereas OILMs are strongly influenced by the people who hold jobs in the occupation’.

There are other differences between firm internal labour markets and occupational internal labour markets worth noting. Althauser and Kalleberg (1981: 130, 131) imply that firm internal labour markets are confined to a single employer, though not necessarily embracing all jobs in a firm, and entry is only at the bottom. ‘A deliberate policy supporting promotion within, coupled with movement up the ladder accompanied with informal training (on-the-job) and education prior to entry is evident’.

Although entry is at the bottom, occupational internal labour markets exist for incumbents of one, two or more associated occupations, and are not necessarily confined to a single employer. Whilst movement up the ladders is facilitated by informal training, ‘the progressive development of skill or knowledge usually requires a high degree of externally acquired (and often theoretical and general) knowledge or skill upon entry’. In occupational internal labour markets, senior incumbents influence entry in a variety of ways, including judging the ability of candidates to meet skill and entry requirements, often having a decisive effect on how many applicants obtain jobs (Althauser and Kalleberg, 1981: 131).

To be sure that one is not confusing these two internal labour market types with the external labour market, other defining features of an external or occupational labour market must be considered. These include:

movement between jobs in the market, job holders having occupational or market identity, ability to organise themselves in a variety of ways such as licensing, certification, or registration, seniority rights according to duration of time in the market often governing jobs, wage levels and increases, and a vulnerability to the development and application of new skills
and knowledge because training is typically specialized and nontheoretical (Althauser and Kalleberg, 1981: 134).

Althauser and Kalleberg (1981: 145) conclude that their framework goes some way to differentiating internal labour market types from the external labour market. However, they state that the next research agenda should be directed towards measuring labour markets in terms of differences in wage levels, wage functions and job mobility.

Outside of Althauser and Kalleberg’s (1981) work, deficiencies in the literature suggest that other human resources indicators need to be considered in more detail when differentiating internal labour market types. These include such indicators as Job Characteristics, Rewards, Professional Identity and Occupational Organisation. Frenkel, Korczynski, Shire and Tam (1999: 60, 64), based on a five-year study of over 1,000 employees and eight leading organisations in three countries, examine the similarities and differences found in a variety of work environments across different occupations. In their research, job characteristics are configured between two ideal types of workers – the routine and the professional. However, their classification of job characteristics refers to only three dimensions – knowledge, creativity and skills – and is not detailed enough to be able to differentiate internal labour markets within the one organisation in the same industry.

Kalleberg and Van Buren (1996a, 1996b) focus on the degree of earnings inequality within organisations. Whilst it was ascertained that those employees who work in large establishments or those with firm internal labour markets earn more and that organisations with firm internal labour markets have less inequality between different kinds of occupations, these findings have limited use for differentiating internal labour market types within the one organisation.

The two other associated indicators, Professional Identity and Occupational Organisation, have only briefly been touched upon by scholars such as Barley (1996) and Tajfel (1978a, 1978b, 1978c). Barley’s (1996) study of technical officers in the medical field adopts such attributes as ‘evidence of formal occupational organization, the importance of on the job training, formal certification required to practice, [and] occupational means of controlling entry’ to construct ideal types in order to determine what technicians do in comparison to ‘Professionals’ and ‘Crafts’. These attributes are relevant; however, they have not been applied to differentiating internal labour market types. Tajfel’s (1978a, 1978b, 1978c) work on social identity considers intergroup behaviour in social contexts. Whilst social identity theory has some relevancy to Professional Identity and Occupational Organisation, the social context is not readily transferable to the organisational context and therefore does not lend itself to differentiating internal labour market types.

In light of the literature addressed in this chapter, what, then, is the best approach for this study?
The outcome of distilling a number of approaches for this case study

The internal labour market theorists discussed in the previous section were divided into those whose work is dedicated to the origins and functions of internal labour markets and those whose work pertains to differentiating labour market types. Turning to the former, the models discussed above (Grimshaw and Rubery, 1998; Rubery and Wilkinson, 1994; Bills, 1987; and Pfeffer and Cohen, 1984), when distilled, all stress similar elements, namely internal and external causal factors, managerial perceptions and beliefs and management strategy. In principle all these factors are relevant to a study concerning the origins and functions of internal labour markets. However, given the nature and degree of changes in any particular industry, it is difficult to pinpoint conclusively isolated or interrelated causal factors from any of the above models and frameworks. This is further frustrated by the rich historical material in which this case study is embedded, a component which the models above have failed to include.

In order to understand change itself one needs to have a much deeper understanding of organisational history. The organisational historical component is crucially important, as a model presented in the next section will demonstrate. It allows one to identify various recurring features highlighted in these models and emerging patterns. Including a historical overview of an organisation enhances one’s understanding of recurring interrelated factors, such as changing internal and external pressures and managerial beliefs and perceptions, that mutually interact to shape management strategy and that ultimately result in the adoption of internalised labour market structures that are appropriate to an organisation and within its industry.

Turning to the second type of internal labour market theorists, the research of scholars such as Althauser and Kalleberg (1981, 1989), which adopts a three-featured structural internal labour market framework, also has particular relevance for future research as it permits to a large extent identification of internal labour market types as mentioned in the last section. However, deficiencies in the literature suggest that other loosely associated human resources features that are not a matter of Althauser and Kalleberg’s (1981) three-featured structural definition but which go some way to further differentiating internal labour market types are important. A new model of the origins and functions of internal labour markets and an expanded typology labour markets is the subject of the next section.
Figure 1.3 Integrated Framework of Factors Shaping Internal Labour Market Structures in Organizations: Royal (1999)

EXTERNAL INFLUENCES
- Historical trends
- Economic environment
- Resources
- Supply & demand for skilled labour
- Institutional factors
- Product/Market
- Technological Change
- Costs
- Search
- Recruitment
- Salaries

INTERNAL INFLUENCES
- Employment relations
- Cultural factors
- Costs
- Training & development
- Career systems
- Performance management and reward systems
- General overhead costs
- Workforce skills
- Need to secure commitment
- Insider-Outsider Relations

Organisational Historical Context

Managerial Beliefs & Perceptions
Managerial Strategy
ILM Structure
A new model of the origins and functions of internal labour markets and an expanded typology of labour markets

The previous section outlined deficiencies in the literature concerning the origins and functions of internal labour markets and in that pertaining to the different labour market types.

In order to address these deficiencies, a model of the origins and functions of internal labour markets and a typology of labour markets have been developed. Firstly, turning to the model (presented on the following page), the previous section stressed the failure by other internal labour market scholars (Grimshaw and Rubery, 1998; Rubery and Wilkinson, 1994; Bills, 1987; Pfeffer and Cohen, 1984) to include an organisational historical component. This has resulted in the inability of these scholars to adopt an integrated approach to understanding the origins and functions of internal labour markets.

The model above indicates the importance of various interrelated features that recur throughout an organisation’s history. These features include changing internal and external pressures and managerial beliefs and perceptions, all of which interact to shape management strategy, ultimately resulting in the adoption of internalised labour market structures that are appropriate to an organisation and within its industry. More specifically, internal influences that affect managerial beliefs and perceptions and management strategy include the state of the employment relations, cultural factors, costs associated with need to secure commitment of employees (such as reward, career and development systems) and insider–outsider relations. External influences that affect managerial beliefs and perceptions and management strategy include historical trends, the competitive nature of the economic environment, institutional factors, the nature of the product market, technological change and the costs associated with recruitment. It is crucial to understand that whilst the internal and external influences are interrelated, they have not evolved in a linear fashion.

By considering the organisational development over time, it is suggested that the features discussed in the model above should serve only as a guide to the origins and functions of internal labour markets and not necessarily as a blueprint for the conclusive reasons for their existence in every organisation, across a variety of industries at any one time. The model cannot explain the exact order of their occurrence, for the simple reason that each organisation has its own unique history, often with gaps, which over time lends itself to more or less emphasis on one or more of the features discussed in the model. Further research calls for more than simply an analysis of the features discussed in the paper. It requires an extensive analysis of the historical evidence – an area which was totally ignored by the data sets used by the other internal labour market scholars when developing their models – and an acceptance that historical gaps make a detailed picture incomplete. However, while it is unlikely that one can simply ascertain the exact causal relationship, the historical evidence does allow one to identify various recurring features and emerging patterns.

The typology of labour markets is presented in the following figure.
<table>
<thead>
<tr>
<th>ILM–HR Indicator</th>
<th>Organisation/Firm Internal Labour Market (FILM)</th>
<th>Occupational Internal Labour Market (OILM)</th>
<th>Occupational Labour Market (OLM)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Job Characteristics</strong></td>
<td>Well defined positions, hierarchical rank. Mainly contextual job-specific knowledge. Often routinised uncreative work, accompanied by management guidelines that circumscribe employee discretion. Technical control. Skills and knowledge accrued informally are firm specific and not portable. Individualised work, little co–worker or customer relations.</td>
<td>Occupational specialists. Application of complex theoretical, specialised, often tacit knowledge associated with knowledge work. Knowledge and skills transferable, imparted through specialised institutions responsible for maintaining standards. Discretion over work processes and goal setting. Team-based work with cooperation and the development of shared understandings between specialists. Control based on peer norms, self-control and professional management observation. Social context important for realising employees’ intrinsic work. Status and prestige important. Learning and mastery of new knowledge and skills necessary. Work involves complex relations between manager and client.</td>
<td>Occupation defined by labour market requirements. Higher level of conceptual knowledge and a wide repertoire of social skills, in undertaking work. Having mastered competencies, work becomes routinised and competencies become transferable across organisations. Occupational discretion over work processes mainly output related. Individualised work, dependent on others to complete work. Complex relations with customer and manager, which are fundamental to nature of work and employee performance.</td>
</tr>
<tr>
<td><strong>Recruitment</strong></td>
<td>Entry at the bottom, thereafter internal. Confined to a single organisation</td>
<td>Entry at the bottom and at higher levels, across several organisations in the same or associated occupations.</td>
<td>External; there are no differentiating levels.</td>
</tr>
<tr>
<td><strong>Basis of</strong></td>
<td></td>
<td></td>
<td>Experience, interpersonal skills, dependability and conformity to established norms. Seniority-rights according to duration of time in the market, often govern access to jobs.</td>
</tr>
<tr>
<td><strong>Criteria</strong></td>
<td>Dependability, loyalty and commitment to organisation’s goals. Workers are role takers and need to become thoroughly familiar with the rules, norms and work procedures.</td>
<td>Qualifications, experience, teamwork skills, access to networks, interpersonal skills, e.g. motivation, innovation, creativity.</td>
<td>Occupational Labour Market (OLM)</td>
</tr>
<tr>
<td><strong>ILM–HR Indicator</strong></td>
<td>Organisation/Firm Internal Labour Market (FILM)</td>
<td>Occupational Internal Labour Market (OILM)</td>
<td></td>
</tr>
<tr>
<td><strong>Training</strong></td>
<td>The organisation.</td>
<td>Professional institutions, tertiary institutions.</td>
<td>Typically TAFE colleges, industry associations, and other certifying institutions, of both short- or long-term duration specialising in non-theoretical courses.</td>
</tr>
<tr>
<td><strong>Main source</strong></td>
<td></td>
<td></td>
<td>Training is likely to be segregated and non-cumulative with respect to certificate or diploma courses. On-the-job training prevalent; often is combined with the formal technical programs.</td>
</tr>
<tr>
<td><strong>Nature of Career Opportunities</strong></td>
<td>Formal training programs aimed at job proficiency and employee development supplemented by on–the–job training.</td>
<td>Undergraduate degree and diploma courses, often acquired before employment, which are typically cumulative and counted toward completion of related higher-level program. On-the-job training - informal, unstructured learning from colleagues. External short-term seminars, workshops and courses delivered by consultants on behalf of the organisation, e.g. management development workshops, technology skills based courses, new product innovation courses.</td>
<td></td>
</tr>
<tr>
<td><strong>ILM–HR Indicator</strong></td>
<td><strong>Organisation/Firm Internal Labour Market (FILM)</strong></td>
<td><strong>Occupational Internal Labour Market (OILM)</strong></td>
<td><strong>Occupational Labour Market (OLM)</strong></td>
</tr>
<tr>
<td>-----------------------</td>
<td>--------------------------------------------------</td>
<td>----------------------------------------------</td>
<td>------------------------------------</td>
</tr>
<tr>
<td><strong>Internal/External</strong></td>
<td>Entirely internal. Clearly defined ladders which are long and vertical. External recruits fill positions at the junior entry level, subsequent positions filled internally according to formalised rules and procedures. Performance appraisal system important.</td>
<td>Mainly external; however, internal career achievement to overcome short vacancy chains is prevalent with progress scaled in terms of increments in skill and experience, resulting in prestige and honour associated with being a specialist.</td>
<td>Job ladders are generally absent. Movement between jobs in the market, i.e. between employers, is highly variable; changes are often instigated by employees.</td>
</tr>
<tr>
<td><strong>Employment security</strong></td>
<td>Establishment of career ladders, implies that the company offers long term opportunities for promotion and employment security.</td>
<td>Variable; depends on external labour market. Employment security is neither sought nor provided.</td>
<td>There are no internal ladders, and no employment security.</td>
</tr>
<tr>
<td><strong>Reward System</strong></td>
<td>Reward system is on a fixed basis to reward dependability.</td>
<td>Reward system based on a bonus component. Structured to encourage and reflect performance.</td>
<td>Reward system is either fixed time related, where pay rises are relative to the number of hours spent at work, or tied to individual output, i.e. contracts or payment-by-results system.</td>
</tr>
<tr>
<td><strong>Criteria for pay rises</strong></td>
<td>Salary grades and bands based on seniority and experience, with rises based on the performance appraisal system.</td>
<td>Performance-related element. Definition and measurement of performance consists of revenue from deals, profit, employee experience and individual or team effort. Performance-based systems often are subjective and are centralised by a few simple rules. Professional societies (not a union), licensing, accreditation boards, professional journals are predominant; professional societies are also used as an occupational means for controlling entry.</td>
<td>External labour market. Seniority rights according to duration of time in the market govern access to wage levels and increases.</td>
</tr>
<tr>
<td><strong>Occupational Organisation</strong></td>
<td>Low level of professional associations or journals. Occupational means for controlling entry is low.</td>
<td>Professionals present theory and knowledge from occupations along with objectivity and rationality to define their status as experts.</td>
<td>Common but not universal to have occupational or market identity in terms of organising themselves by unionisation, some have professional associations, others have none; licensing, certification or registration are typical by-products of this feature. Main way of exerting occupational control over entry is primarily through union control of apprentice programs. Identify more with the profession than with the organisation.</td>
</tr>
<tr>
<td><strong>Professional Identity</strong></td>
<td>Do not necessarily regard themselves as a member of a profession or identify more with the organisation.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Secondly, consider the typology of labour markets presented above. Following on from Osterman’s (1984b: 166) observations that in reality ‘most organisations contain several different internal labour markets operating with different rules and procedures’, a typology has been developed to analyse the research questions and hypotheses proposed in this case study. This will be used as a blueprint for differentiating internal labour market types. The typology focuses predominantly on the three defining structural features that Althauser and Kalleberg (1981: 130) use to ‘distinguish the two types of internal labour markets, firm internal labour markets and OILMs [occupational internal labour markets], from the external labour market or OLM [occupational labour market]’. These features were discussed in the previous chapter. Once again, they include

entry at the bottom, the existence of a job ladder, and movement up the ladder which is associated with a progressive development of knowledge and skill. Lack of any one of these three basic characteristics reflects an external labour market or OLM.

The typology depicted in Table 1 refers to these structural features as the Recruitment, Career Opportunities and Training human resource indicators. Previous discussion in this paper of Althauser and Kalleberg’s (1981) work suggests that whilst the three features are common to both internal market types, that is, firm internal labour markets and occupational internal labour markets, there are distinguishing differences. These differences were also discussed earlier in this paper at some length and are now highlighted under the Recruitment, Career Opportunities and Training indicators in the typology Table 1. It is worth noting that whilst the first defining feature pertains to the Recruitment indicator and the second one to the Career Opportunities indicator, the third defining feature structural feature, ‘movement up the ladder associated with a progressive development of knowledge and skill’ (Althauser and Kalleberg, 1981: 130), requires the incorporation of the components outlined in the Training indicator.

It will be recalled from the previous two sections that outside of these three indicators, there are gaps in the current literature which suggests that there are other human resource indicators that can be associated with establishing the existence of different labour market types. Other human resource indicators include the Rewards, Job Characteristics, Professional Identity and Occupational Identity indicators.

Hence, it can be seen that the model of the origins and functions of internal labour markets and the typology of labour market types are fundamental to the analysis of any future research questions in the field. How these can best be applied, given the different approaches that are available to social science researchers, is yet to be ascertained.
Conclusion

This paper has attempted to highlight the significance of the internal labour market construct for future employment arrangements in organisations. Kalleberg, Knoke, Marsden and Spaeth (1996: 88) state that these arrangements are a central feature of employment relations in modern industrial societies.

As Osterman (1984b: 166) states, it is inappropriate to assume that a given enterprise has only one internal labour market when the reality, more often than not, is that scholars are likely to find a number of different labour market arrangements operating with different rules, practices and procedures within a single enterprise. These are also likely to vary, as Doeringer and Piore (1971: 2) suggest, among industries and occupations.

As has been suggested, the flexible firm model has strong links with the internal labour market construct. It has also been suggested that while the flexible firm model discriminates between the core workers in the primary market and the periphery workers in the secondary market, with the former enjoying the benefits of the internal labour market arrangements, and despite the conceptual flaws of the model itself, it is still important for scholars to be aware that for some firms the concept of the flexible firm is meaningful.

From the employment trends that are available, it is too early to conclude that internal labour markets in the United States are in dramatic decline. To test some of the hypotheses raised by Cappelli (1995), one requires, as Milner (1995: 610) implies, United States workplace data similar to that of the British Workplace Industrial Relations Survey and the Australian national representative workplace industrial relations survey. Without a United States survey, one really knows very little about the changing nature of industrial relations, human resource management and the employment relationship.

What is evident from the National Organizations Study conducted in 1991 by Kalleberg, Knoke, Marsden and Spaeth (1996: 88), which covered 772 American organisations across a diverse range of industries, is that internal labour market arrangements in modern industrial society are significant. The study indicated particularly the firm internal labour market kind.

Benson (1995: 604) states that:

the issue isn’t really whether internal labour markets are present or not in an organisation but rather the degree to which they exist. Changes or various strategies used by many firms to improve performance may alter the emphasis given to managing internally but do not necessarily put them at risk.

The evidence presented in this paper highlights a more complex situation emerging, one which stresses the importance of an integrated approach for understanding the origins and functions of internal labour markets. This serves to direct the theoretical focus away from the exclusive emphasis on economic explanations, human capital (institutional), transaction or radical approaches, towards an integrated
model. This kind of model emphasises a range of interrelated elements, including external and internal causal factors, managerial perceptions and beliefs, and management strategies. However, discussion in the latter part of the paper indicates that given the nature and degree of change experienced by many organisations, it is difficult for internal labour market scholars and their models to pinpoint conclusively interrelated or isolated causal factors as an explanation of the origins and functions of internal labour markets. This is further complicated by the failure of internal labour market scholars’ models to include an organisational historical component. It is strongly argued in this paper that the inclusion of an organisational historical component would permit identification of recurring interrelated elements relating to the origins and functions of internal labour market, elements that are the foundations of the theoretical models proposed by some of the internal labour market scholars discussed in this chapter.

More importantly, this chapter has stressed the importance of differentiating internal labour market types. Bills (1987: 202) further states that, in general, scholars’ research of internal labour markets has also been hindered by the

lack of detailed material describing the economic and organizational dimensions of their design and implementation, and by the neglect of managerial perceptions of the motivations for constructing internal labour markets.

Once again, a new model stressing an organisational historical component and an expanded typology of labour markets are very relevant to the process of establishing the existence of an internal labour market and in differentiating types.
References


Pollert, A. (1987), ‘The “flexible firm”: a model in search of a reality (or a policy in search of a practice?)’, Warwick Papers in Industrial Relations 19, IRRU, School of Industrial and Business Studies, University of Warwick.