Insurance Between Firms: The Role of Internal Labor Markets*

Giacinta Cestone[†] Chiara Fumagalli[‡] Francis Kramarz[§] Giovanni Pica[¶]

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Abstract

We investigate how internal labor markets (ILMs) affect labor adjustments and performance in business groups. We show that group-affiliated units faced with *positive* shocks to growth opportunities rely on the ILM to ensure swift hiring, especially of managers and other high-skilled workers. A closer access to the group's human capital facilitates employee relocations and causes additional productivity and market-share gains in the aftermath of the shock, suggesting that ILMs help group members fully exploit growth opportunities. *Adverse* shocks affecting one unit in the organization increase workers' mobility to other group units rather than to external firms, with stricter employment protection causing an additional increase in internal mobility. Overall, ILMs emerge as a co-insurance mechanism, allowing organizations to bypass hiring and firing frictions and providing job stability to employees as a by-product.

Keywords: Business Groups, Human Capital, Labor Market Frictions, Internal Labor Markets

JEL Classification: G30, L22, J20

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[†]Cass Business School (City, University of London) and ECGI

[‡]Università Bocconi (Department of Economics), CSEF and CEPR

[§]CREST(ENSAE)

[¶]Università della Svizzera Italiana (USI), Centro Luca D'Agliano, CSEF, Paolo Baffi Centre