INTERNAL MARKETS:

Bringing The Power of Free Enterprise INSIDE Organizations

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Introduction:

THE SINGLE MOST IMPORTANT CHANGE IN MANAGEMENT TODAY

As the world rushes into an information age of complex technologies, global markets, intense competition, and turbulent, constant change, the institutions that worked in the past are failing everywhere. Witness the collapse of communism, a crisis in government bureaucracies around the world, and the decline of corporations like General Motors, IBM, and Sears that were once models of successful management.

The enormity of this problem becomes evident by comparing it with the similar upheaval created by the industrial revolution two centuries ago. Just as the medieval castle, the monarchy, and other institutions of an agrarian era were transformed by the relentless advance of industrial technology into our present world, now the relentless advance of information technology is transforming society once again.

And today's breathtaking changes are merely a prelude to what is coming soon. The information revolution continues to roar ahead, steadily multiplying computing power by a factor of 10 every few years with no end in sight. John Scully, the visionary CEO of Apple Computer, put it this way: "So far we have been racing to the starting line. The really interesting stuff begins in the 1990s." 1

The impact of this revolution amounts to a social earthquake, toppling our old pyramids of power to clear the landscape for new economic structures built on dynamic management principles able to master a knowledge-based global order. 2 This book describes the new economic foundation of management emerging to meet this challenge, a dramatically different system of entrepreneurial management that harnesses the power of free markets *WITHIN* organizations Ä ***INTERNAL MARKETS.***

NEW QUESTIONS ABOUT OLD BELIEFS

This unprecedented upheaval has forced executives to drastically restructure their companies. Massive layoffs, downsizing, and the elimination of layers of management have pruned most organizations back to their essential parts. These hierarchical skeletons are being fleshed out with a maze of cooperative ventures among competitors, alliances between suppliers and customers, research consortia uniting entire industries, and other innovative corporate structures.

Yet, the decline of big business continues unabated because these changes miss the heart of the problem. With a few notable exceptions, CEOs in industry after industry are feeling mounting frustration as their traditional wisdom prove ineffective in coping with an avalanche of confusing change. Where corporate Goliaths such as IBM and AT&T once gained crushing competitive power from their vaunted economies of scale, now size is proving a liability against nimble Davids like Apple, Microsoft, and MCI Ä who may in turn suffer the same fate as they grow bigger.

A conceptual barrier is blocking our best efforts, causing a serious reexamination of basic assumptions about the nature of enterprise itself; new questions are being raised about the very notion of what a corporation or government agency consists of and how it should be organized and managed. Is size now fatal? Must the growth that accompanies success necessarily bring decline? How can small firms manage a global economy? If large organizations are decentralized into federations of smaller companies, how can they be coordinated without impairing flexibility? Can ***any*** structure remain useful for long in a world of constant change? Consider a few other examples of this conceptual dilemma. Large corporations comprise economic systems that are larger than all but the largest national economies. Yet most executives and scholars think of these corporate economies as "firms" to be managed with centralized controls. Listen to any typical discussion of corporate strategy and you will hear learned people talk of moving the resources of corporations about like a portfolio of investments, dictating which factories around the world should produce which products at which prices, setting annual and even quarterly targets for individual units, hiring and firing managers. How does this approach differ from the central planning that failed so utterly in the Communist bloc? Why would centralized controls be bad for a national economy but good for a ***corporate*** economy?

The great size of most corporations requires breaking them down into manageable divisions that constitute complete companies in their own right. Many of these divisions would rank in the Fortune 100 if considered separate firms, and some global corporations, such as Asea Brown Bovari (ABB), have thousands of profit centers. These units usually have their own distinct markets, clients, and competitors. At various times, they may sell their products to other divisions within the parent corporation, compete against one another for the same customers, and even award contracts to outside competitors. Again, troubling questions are raised about the nature of enterprise. What is best for the parent corporation as a whole? For the divisions? How do these "collections of small enterprises" differ from an ordinary market economy? Why should they remain together at all? In short, what truly ***is*** a corporation?

Our final example is from the public sector. The concept of educational choice is gaining acceptance, in which competition holds individual schools accountable for performance. Will this be sufficient to improve the old educational bureaucracy? Should schools be closed if they cannot compete? Should ***all*** public agencies allow their clients to select among competing units? Although these unorthodox new issues violate tenets of traditional management principles, they are becoming commonplace. The effect of such heresy has been to challenge the prevailing paradigm of centrally planned, hierarchical organizations, which we believe is now obsolete. When Max Weber based today's "theory of bureaucracy" on principles of authoritarian hierarchy as the industrial age began, the concept was revolutionary because it brought huge gains in rationality, efficiency, and order. Now it means almost exactly the opposite: irrational adherence to petty rules, inefficient and unwieldy systems, and disregard for mounting chaos. The most damning thing a critic can say about an organization today is to call it a "bureaucracy."

The very system that once caused great success is now the cause of great failures. As our familiar old institutions began declining recently, the age of hierarchical organizations ended. What will take their place?

ORIGINS OF THE NEW MANAGEMENT PARADIGM

This book, ***INTERNAL MARKETS***, presents a new way of thinking about the nature of modern organizations. It is a collection of the pioneering work of notable executives, academics, and consultants who are creating a strikingly different, more powerful perspective of large institutions for a new economic era governed by the imperatives of information technology. Internal markets are "metastructures," or "***super***structures," that transcend ordinary organizational structures. Rather than being fixed structures, they are systems designed to produce continual, rapid, structural change to manage the unusual demands of today's complex, turbulent world.

A variety of well-known metastructural concepts of this type are emerging now Ä flat organizations, intrapreneurship, organizational networks, groupware, reengineering, the virtual corporation, and many other creative innovations. How does this book differ from the wave of other publications offering a flood of hot new business ideas?

The concepts described here are compatible with this literature, but they go beyond it to put today's innovations in perspective as part of a larger management revolution. INTERNAL MARKETS carries today's evolution of management thought to its logical conclusion by providing a broader conceptual foundation based on the principles of free enterprise: complete internal market economies that bring all the advantages of free markets INSIDE large organizations, just like external economies.

Some of the ideas that led to this perspective have their origins in the classic works of famous scholars and practitioners. Alfred Sloan invented the concept that a large corporation should be decentralized into semiautonomous divisions, but his vision was lost as the GM bureaucracy grew to its present overblown condition.

The first widely-published formulation of internal markets seems to have been made by Jay Forrester of MIT in a 1965 article [3] that is reprinted in this book. At about that time, other pioneering scholars, such as Warren Bennis, 4 were warning of the impending demise of "mechanistic" bureaucracies and the need for "organic" structures, a term that nicely captured the spirit and feel of the coming revolution in management. Some creative executives, such as Robert Townsend, CEO of Avis, struggled to free their firms from the growing encrustation of bureaucracy. [5]

But the organic concept remained too vague for effective implemention because it lacked the central idea of market mechanisms, and the need for such great changes was not yet urgent enough to challenge deeply entrenched management beliefs. In 1984 Townsend issued a poignant summary of the problem: [6]

> The folks in the mailroom, the president, the vice presidents, and the steno pool ... [are all] trapped in the pigeonholes of organization charts, they've been made slaves to the rules of private and public hierarchies that run mindlessly on because nobody can change them.

In retrospect, these early attempts at change generally failed because the transition to a new structural form constitutes an historic shift, and history is not driven by logic but by necessity. Major institutional change usually occurs only when environmental forces threaten survival.

Not until the turbulent 1980s did the United States finally experience an onslaught of corporate restructuring. The economic crisis of 1982, an invasion of Japanese firms onto American soil, a rush of technological change, and other such traumas forced executives to seriously rethink corporate designs. During this decade of creative change, Russell Ackoff, William Halal, Ali Geranmayeh, and John Pourdehnad were independently constructing their individual versions of the new management paradigm that converged into the work leading to this volume.

Ackoff had been building the concept of internal markets at the Wharton School, and in 1981 he outlined its key principles from the view of management science with the publication of *Creating the Corporate Future* (Wiley). Meanwhile at George Washington University, Halal started from a different perspective of strategic adaptation to a changing environment, but reached a similar conclusion in 1986 with his book, *The New Capitalism (Wiley). Ali Geranmayeh and John Pourdehnad, Ackoff's colleagues at INTERACT, The Institute for*

Interactive Management, were implementing these concepts through their consulting practice to develop a tested methodology of organization restructuring.

These different paths joined in 1990 when a consulting project undertaken by INTERACT occasioned a visit to Halal's office. Because the idea of internal markets was quite unknown at that time, it soon became apparent that a major meeting was needed to attract national attention, which then led to the 1991 Conference on Internal Markets at Washington, DC, jointly sponsored by George Washington University and INTERACT.

To the best of our knowledge, this was the first meeting ever devoted to the topic. The conference attracted 100 leaders from business, government, academe, and consulting, most of whom had been experimenting with their own applications of the same idea. Once underway, the participants soon verified that the internal market perspective was intellectually sound, practically workable, and badly needed.

Later, all agreed that the relevant papers should be collected for publication, along with the work of others who could not attend. This book is the result of that effort. It is not a report of the conference proceedings, but rather a collection of what we consider to be the best available thought on the subject.

The following summary briefly describes the essence of the new management paradigm in terms of three central principles:

An Organization Is Composed of Internal Enterprise Units*An organization is composed of numerous "internal enterprises" that form the building blocks of the corporate system. All internal enterprises, including line and staff units, are accountable for performance but gain sole control over their own operations, as in any ordinary "external enterprise." This concept can also be carried down to the grass roots by decentralizing enterprises into autonomous work teams. Alliances between internal enterprises and work teams in different corporate systems link individual organizations together to form a global economy.*

Corporate Executives Manage the Organizational Infrastructure *Rather than managing operations through the chain of command, corporate executives design and regulate the infrastructure of their "organizational economy" just as federal governments manage national economies: establishing common systems for accounting, communications, financial incentives, education, governing policies, and the like. Top management may also encourage the formation of various business sectors that would exist in an economic system: venture capital firms, consultants, distributors, and so on.* ***Leadership Fosters Collaborative Synergy*** *This system is more than a laissez-faire market, but a "community of fellow entrepreneurs" that fosters collaborative synergy by encouraging joint ventures and alliances, the sharing of technology, solutions to common problems, and mutual support among both internal and external partners. Corporate executives are the senior members of this community, so they provide the leadership to create a collaborative corporate culture, resolve obstacles, and guide this internal market in its shifting development of various strategies.*

This brief summary cannot convey the full implications involved, nor can it answer the difficult questions we raised at the onset, especially because the internal market concept entails a paradigm shift that completely reorganizes prevailing management thought. That task is left to the following chapters. However, if one grasps the central concept that an internal market economy replicates the features of an external market economy, the remaining elements and behavior of market super structures become fairly straightforward. The many examples of progressive corporations and governments that have adopted such systems demonstrate some striking results.

As a community of entrepreneurs uses its freedom to launch new products and services, hire and fire, buy and sell, both internally and externally, the same self-organizing, creative interplay occurs that makes all market economies so advantageous. Powerful solutions to difficult problems emerge quickly and almost spontaneously, spawning a rush of economic growth that could not conceivably have been foreseen, much less planned, by the most brilliant hierarchical system. Markets have their drawbacks, of course, but they are spreading around the globe because they excel over the only other alternative Ä central planning Ä whether in communist governments or capitalist corporations.

In both nations and organizations, planned economic systems are too cumbersome to cope with the avalanche of confusing, chaotic change now rushing down on society. The internal market paradigm is advantageous under these turbulent conditions because it is a ***conceptual system for creating strategic organizational change.*** *Free enterprise, whether internal or external, remains the only economic philosophy able to produce an unending stream of adaptive change rapidly and efficiently.*

TAKE AN INTELLECTUAL JOURNEY THROUGH ***INTERNAL MARKETS***

Because the world is experiencing an historic upheaval, the most formidable challenge facing all of us is to reframe our prevailing beliefs. It is hard for most people to conceive how organizations can work without central control because we live in a culture based on hierarchy. The ideas in this book are valuable because they provide this vision, but they also require us to seriously consider a new mode of thought that seems illogical from our current point of view. When the concept of market metastructures is presented groups, the first reaction often is that the idea is unworkable and bizarre.

The following chapters present this new paradigm in the most coherent, easily understood manner possible, but this will mean little unless you can make a mental shift in your present beliefs about the way organizations work. The authors of these chapters challenge the reader to temporarily accept the possibility of understanding organizations from a dramatically different perspective that violates many commonly accepted rules: control can be best achieved through freedom; security is increased by accepting risk; structure is enhanced by change. By permitting yourself to explore this intellectual journey into a different world of market-based superstructures, you may return with a far more powerful, dynamic, and liberating perspective of institutions.

Part I provides a conceptual overview of this new management perspective. Russell Ackoff begins by asking us to consider the similarities *between corporate and national economies, with the striking conclusion that capitalist corporations should be making the same structural changes now underway in former Communist governments. William Halal then shows how various trends all suggest that market systems represent the paradigm of the information age, with their own advantages and disadvantages, management imperatives, forms of behavior, and leadership. Jay Forrester updates his seminal 1965 article with current thoughts about the most crucial changes needed in American corporations. Raymond Miles and Charles Snow examine the strengths and limits of various organizational networks, presenting a different view of the internal market perspective. Peter Senge points out the limits of internal market structures, showing how learning processes are also badly needed. Finally, Ali Geranmayeh and John Pourdehnad tackle the difficult questions raised by internal markets to help readers evaluate the concept.*

Part II offers the firsthand experiences of pioneering executives who have led their corporations through the transition to internal market systems and related metastructures. Bert Roberts and John Zimmerman outline the principles of their corporate culture that have made MCI such a dynamic organization. John Starr describes how internal markets revitalized Alcoa by reintroducing the company to economic reality. James Rinehart offers highlights from his career at General Motors and Clark Equipment to suggest that even the CEO's office should become a profit center. David Noer recalls the lessons he learned in converting Control Data's support units into internal consulting firms. Julio Bartol and Ali Geranmayeh draw on their experiences with Armco's Latin American division to present a practical approach for linking internal markets and corporate strategy. John MacLean shows how a decentralization strategy transformed Canadian Imperial Bank of Commerce. Joseph Gamble, Michael Sheehan, and Seton Shields examine the problems and benefits they encountered forming subsidiaries to jump start Blue Cross/Blue Shield. And John Charlton offers plans underway to make the R&D function at Esso Petroleum of Canada a self-supporting enterprise. All of these personal accounts include frank analyses of the challenges these companies faced, the issues they wrestled with, and their successes and failures.

Part III then provides similar first-hand accounts that extend this discussion to the public sector. James Pinkerton passes on to the Clinton Administration the "New Paradigm" of government that he proposed during the Bush Administration. David Osborne applies the principles of this entrepreneurial form of government to sketch out a plan for Washington, DC. William Halal, Charles Blake, and Kathryn Sheldon Hammler conclude with a study showing that the federal government is adopting internal markets.

A CORPORATE PERESTROIKA FOR THE INFORMATION AGE

These chapters have their limits individually, but taken together, they show that the transition from hierarchy to enterprise is well underway, with profound implications. In a decade or so, our prevailing notion of management may seem as archaic as the medieval belief in the divine right of kings. Instead of today's fervent conviction that organizations must inevitably be top-down, hierarchical pyramids of power and constraining rules, the idea of market metastructures should create a different form of entrepreneurial management based on the same principles that guide external market systems.

There are caveats. No organizational design can be perfect, so internal markets incur risks, inequalities, and other messy problems of market systems. Like all broad management frameworks, the market perspective offers a conceptual approach, rather than detailed solutions, which each manager must adapt to his or her own needs. In fact, this approach may not be appropriate for some organizations. And, as Peter Senge points out, structural change does not address behavioral issues directly, which is why an internal market must be designed as a total system that includes new processes for organizational learning, decision making, and other behavioral factors.

Russell Ackoff reminds us in the foreword, however, that a market orientation is the first imperative for revitalizing institutions because it defines the structural foundation supporting all other aspects of management. By organizational ***structure****, we mean the way managers design operating units, join them together in working relationships, set up reward systems, form communication channels, and so on; organizational* ***behavior*** *describes how people act within this structure Ä workers doing their jobs and managers leading. A sound structure does not* ***assure*** *effective behavior, but it is an essential starting point. It is necessary but not sufficient. As we continually point out in this book, talented employees, collaborative leadership, inspired strategies, and other factors are also needed to create excellence. However, these are secondary causes because it is difficult for people to work effectively in a faulty structural foundation. Structure is the first requirement for good management.*

That is the basic problem facing managers today. Capable, well- intentioned people working in General Motors, IBM, the federal government, schools, hospitals, and other organizations are struggling against outmoded bureaucratic structures. American society must redesign its institutions into modern superstructures built on market concepts appropriate for a new economic era. [7]

This impending shift to a dynamic model of organization forms the single most important change taking place in economics today. Modern nations such as the United States are in the throes of a management revolution that presents roughly the same challenges and opportunities posed by today's restructuring of socialist economies Ä a "corporate Perestroika for the Information Age." To quote John Scully [8] again:

The command-and-control model of running a large organization no longer works... the single biggest theme in the world of business during the 1990s...[will be] the reorganization of work using information systems to compete in the marketplace.

If the United States can rise to this challenge, we could harness the creative power of American individualism to regain competitive leadership in a global economy. A hopeful factor is that this would be a logical extension of the American principles of democratic free enterprise that are now creating revolutions around the world. Internal market metastructures offer the same powerful advantages of free markets that have overthrown communism: myriad opportunities for achievement, liberation from authority, accountability for performance, entrepreneurial freedom, creative innovation, high quality and service, self-organization, ease of handling complexity, fast reaction time, flexibility for adaptive change, and great personal and financial rewards.

To realize these possibilities, however, we must recognize the crucial but difficult new idea that organizations can be more effectively understood, designed, and managed as market economies in their own right to create a far more dynamic, liberating, and productive new class of organizational metastructures. The evidence in the following chapters shows that powerful forces are moving in this direction, but confusion reigns because a useful concept has been lacking to capture this new economic reality now emerging quite rapidly. This book presents that concept.

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3. See Jay W. Forrester, "A New Corporate Design," Industrial Management Review (Fall, 1965), Vol. 7, No. 1, pp. 5-18, which is reprinted in this book. We are indebted to Rick Forschler, Boeing Engineering Corporation, for calling our attention to another early article describing a manufacturing plant in Dayton, Ohio, that invented a similar management system: John C. Sparks, "Production Unlimited," The Freeman: A Monthly Journal of Ideas on Liberty (March 1962), Vol 12, No. 3. Back to document

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14 (2) EC defines the Internal Market as â€˜an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured.â€™ These basic freedoms are guaranteed in further provisions of the Treaty which the Court of Justice has interpreted as producing direct effects. Completing the internal market in products and services and making it the launch pad for our companies and industry to thrive in the global economy. Stimulating investment in new technologies, improving the business environment, easing access to markets and to finance, particularly for SMEs, and ensuring that workers have the skills industry needs. Internal marketing is here again. It first appeared as a concept a few years ago, then disappeared from the business press as new ideas came to fruition. But now it seems that internal marketing is back and being talked about again. What is internal marketing and why is it important? Advertisement. Before assessing the merits of internal marketing. it is necessary at least to define the term â€œmarketingâ€.

Internal marketing is inward facing marketing. Internal marketing is used by marketers to motivate all functions to satisfy customers. With internal marketing the marketer is really extending and developing the foundations of marketing such as the marketing concept , the exchange process and customer satisfaction to internal customers. Internal customers would be anybody involved in delivering value to the final customer.