

Friendship Ties on Boards

Research that recently appeared in the *Strategic Management Journal* shows that although it is illegal to create interlocking boards with competitors, many firms effectively create such interlocks by including friends of a competitor firm's CEO on their board. These "pseudo" interlocks, which have not received much attention by academics or regulators, result in reduced competition and higher financial performance.

Key Takeaways:

- Although board interlock ties between close competitors are illegal, many firms appoint "friends" of competitor's CEOs to create "board-friendship" ties.
- Firms that appoint a friend of a rival firm's CEO reduce competition and increase financial performance.

Using data derived from survey responses of CEOs and directors on 509 companies with more than \$100 million in annual revenue, the researchers examined friendship ties based on answers to relevant questions asked to directors serving on nominating committees. The researchers combined survey responses with demographic and board membership data on CEOs and Directors to create the data used in this study. Researchers found that

the level of competitive uncertainty in an industry is positively associated with the likelihood that a board will include the friend of a CEO of a firm's competitors.

The research team also found that the positive relationship between boards having friends of a rival firm's CEOs and competitive uncertainty occurs through the use of headhunter solicitation of director candidates from the competitor's CEO.

Their analysis statistically controlled for aspects of the environment (like year and industry), the firm (like recent firm performance, firm size, and board size), and other types of ties between firms (like common board appointments and joint ventures). The authors suggest that future research is needed to identify behavioral evidence regarding the specific activities that may occur to affect these relationships.

Source: Westphal, J. D., & Zhu, D. H. (2019). Under the radar: How firms manage competitive uncertainty by appointing friends of other chief executive officers to their boards. *Strategic Management Journal*, 40; 79-107.