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Under the Radar: Firms Manage Competitive Uncertainty by Appointing Friends of "Rival" CEOs to Their Boards

And that can cause income increases in the tens of millions of dollars

While firms face regulatory barriers to the use of board interlocking ties as a strategy for reducing competition, a new study suggests that firms can circumvent these barriers by appointing the friends of competitors' CEOs to their boards.

The research, *Under the Radar: Firms Manage Competitive Uncertainty by Appointing Friends of "Rival" CEOs to Their Boards* by James D. Westphal, University of Michigan and David H. Zhu, Arizona State University, will be published October 25 in the Strategic Management Society's Strategic Management Journal.

"Board ties in the form of interlocking directorates provide a potential mechanism by which top executives can coordinate firm decisions and reduce competition," write the authors. "However, concern about board ties among academics and policy-makers has declined in recent years because the Clayton Act has prohibited interlocking directorates among firms that compete in the same industry, if combining these firms would violate antitrust laws.

"In addition, it has become increasingly impractical to form and maintain board interlocking ties in which the CEO of one firm serves on another firm's board."

However, Westphal and Zhu dispute the widespread perception that directorship ties no longer play a significant role in inter-firm collusion.

"In particular, we contend that relatively high competitive uncertainty in an industry will encourage firms to appoint the friends of rivals' CEOs to their boards to facilitate inter-firm coordination, creating board-friendship ties to rivals," write the authors.

An outside director who is a friend of a rival's CEO is in a position to help assure the rival firm's cooperation as research suggests that outside directors are increasingly involved with firms' major strategic decisions and hence are well exposed to the firm's strategic plans.

The friendship between the director and the rival's CEO further renders both CEOs more willing to trust information from the director about the plans for inter-firm cooperation.

Companies also appear to use headhunters to find these "friendly" board members and to restore ties that have been broken.

The study examined large- and medium-sized public companies in the U.S. with more than $100 million in annual revenues with the final sample consisting of 509 firms.

"Our first set of results show that the level of competitive uncertainty faced by a firm is significantly and positively related to the formation of friendship ties between a firm's outside directors and rivals' CEOs," write the authors. "Additional results suggest that firms were more likely to reconstitute broken board friendship ties if they face relatively high levels of competitive uncertainty.

"These findings are consistent with our theoretical expectation that firms seek to manage competitive uncertainty by creating and maintaining board-friendship ties to rivals."

The research also found considerable evidence that executive search firms mediated the formation, maintenance and reconstitution of these ties.

"Additional results provided evidence that board-friendship ties to rivals are associated with higher subsequent firm performance," write the authors. "In particular, an additional board-friendship tie to competitors improved a firm's net income by approximately $134 million on average.

"Supplemental evidence provided further support for our theoretical argument regarding the mechanisms by which board-friendship ties to rivals increase firm performance. In particular, analysis of our survey data corroborated our theoretical argument that board-friendship ties facilitate inter-firm coordination that enables firms to reduce competition on price and other contract terms."

The **Strategic Management Journal** (**SMJ**) is the official journal of the **Strategic Management Society (SMS)** and published by Wiley. The SMS is comprised of 3,000 academics, business practitioners, and consultants from 80 countries and focuses on the development and dissemination of insights on the strategic management process. SMJ, which publishes 13 issues per year, is consistently rated one of the top publications in the management area and publishes papers that are selected through a rigorous double-blind review process

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