Understanding Strategic Change in a Business Group Affiliated Firm: Role of Internal & External Interlocks

BY

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ABSTRACT

Following calls for opening the black box of business groups (Carney et al., 2011; Khanna & Rivkin, 2001; Manikandan & Ramachandran, 2015; Yiu et al., 2005), we attempt to understand what shapes the two aspects of strategic change in a business group affiliated firm, namely, variation and deviation. Strategic variation refers to changes in the pattern of a firm's resource commitment over time, while strategic deviation refers to changes in the pattern of a firm's resource commitment from the central tendency of competitors in the industry (Carpenter, 2000). As the board of directors of a firm sets its overall strategic direction, it may be gainful to study the role of the board of directors in understanding strategic change.

Directorate interlocking happens when a person serves on more than one board; as directors of different boards usually interact via interlocks (Mizruchi, 1996), we investigate the role of interlocks on the strategic change of affiliated firms. Business group structure provides for distinct legal entities with separate boards – this implies that interlocks for a firm can happen with other constituent firms of the same business group; terming such interlocks as internal (following Maman, 1999) and all others as external interlocks, we attempt to understand their differential effects on the two aspects of strategic change. We suggest that internal interlocks reduce, while external interlocks increase strategic variation, whereas both the interlocks increase strategic deviation.

Furthermore, business group embodies a social network structure where member firms are interconnected (Granovetter, 1995). The strong sense of social identity in business groups indicates that affiliate firms could prefer to follow the strategy of the overall group rather than chart a path of their own, regardless of performance implications, thus necessitating the need to understand how strategies of affiliated firms move with respect to that of overall group. In the light of this, we propose yet another aspect of strategic change, namely 'strategic allegiance,' defined as the similarity in the pattern of a firm's resource commitment from the central tendency of member firms of the business group. Here, we suggest that internal interlocks increase while external interlocks reduce strategic allegiance.

We find empirical evidence that internal interlocks reduce, while external interlocks increase strategic variation. We also find that internal interlocks increase both strategic deviation and strategic allegiance. We conclude with implications for theory and practice.

Keywords: *Business Groups, Strategic Change, Interlocks, Strategic Allegiance*

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