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Managers' external social ties at work: Blessing or curse for the firm?☆

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ABSTRACT

Existing evidence shows that decision makers' social ties to internal co-workers can lead to reduced firm performance. In this article, we show that decision makers' social ties to external transaction partners can also hurt firm performance. Specifically, we use 34 years of data from the National Basketball Association and study the relationship between a team's winning percentage and its use of players that the manager acquired through social ties to former employers in the industry. We find that teams with "tie-hired-players" underperform teams without tie-hired-players by 5 percent. This effect is large enough to change the composition of teams that qualify for the playoffs. Importantly, we show that adverse selection of managers and teams into the use of tie-hiring procedures cannot fully explain this finding. Additional evidence suggests instead that managers deliberately trade-off private, tie-related benefits against team performance.

1. Introduction

A person's social relations are a key influence factor for her attitudes, preferences, and (economic) decision-making. When searching for a job, for example, individuals have been found to frequently rely on information and resources from their social contacts (Montgomery, 1991; Bewley, 1999; Ioannides and Loury, 2004; Jackson, 2006). In the workplace, *newly* formed social ties to others *within* the firm have been found to affect employee productivity and overall firm performance (Bandiera et al., 2005, 2008, 2009, 2010).

This paper documents field evidence on whether and how employees' *history* of social relations and experiences *outside* the firm influences firm-level decision-making and overall firm performance. We focus on a prominent form of historical, external social relationships: pre-existing, strong social ties to colleagues at a former employer in the same industry. Such ties are potentially very influential for firm-level decisions, as they create opportunities for on-going business transactions (e.g., resource acquisitions). However, the question whether tie-influenced transactions pose a blessing or a curse for the

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firm remains unresolved. On the one hand, external ties to others in the industry may help firm performance, as they provide superior access to relevant market information. On the other hand, it is reasonable to expect that external social ties can harm firm performance if they interfere with employees' optimal selection of transaction partners.[1]

To determine the overall performance effect of tie-influenced transactions we construct a novel dataset from an unusual but interesting industry: the National Basketball Association (NBA).[2] Specifically, we use the complete event history of the NBA in its current form (since 1977) and combine a team's record of player acquisitions and sporting performance with data on the working history of its key decision maker: the general manager. Our empirical focus lies on the performance effect of player acquisitions that the general manager[3] makes from his former employers in the NBA. Therefore, we test the null hypothesis that teams with "tie-hired-players" show identical sporting performances as teams without tie-hired-players.

Four characteristics make our unusual setting ideal to study the overall performance effect of managers' external, social ties. First, each team employs only one manager at a time who is ultimately responsible for the team's most important transactions: player acquisitions. Second, we have industry-wide information on each manager's complete working history, and the identity of his former colleagues (i.e., team owners and head coaches). In each season, this allows us to identify each manager's set of active, strong social ties to other teams in the NBA. Third, we observe the number of game appearances for each player in the industry, which allows us to measure the relative importance of tie-hired-players in team production. Finally, we observe an objective measure of team performance: the team's sporting success in the regular season.[4]

Our empirical analysis shows that the effect of tie-hired-players on team performance is negative. Based on a simple mean comparison, we find that teams with tie-hired-players underperform teams without tie-hired-players by a substantial 11 percent. Subsequent regression analyses reveal that this difference in winning percentages stems from teams' use of tie-hired-players on the court and not from (unobserved) quality differences of teams and managers: controlling for manager and team fixed-effects, a team's budget, and other observable characteristics, the average tie-hired-player reduces team performance by about 5 percent. Importantly, we show that the negative performance effect of tie-hired-players is robust across two additional social tie definitions that include up to 190 tie-hired-players.

In an extended analysis, we address the underlying mechanism for this finding and show that tie-hired-players reduce team performance only if they have been acquired in the presence of low monitoring incentives for team owners. Our estimation approach builds on different streams of psychological research (e.g., Schoorman, 1988; Shepherd et al., 2009) suggesting that monitoring incentives should be lower for an owner who personally hired a manager than for an owner who "inherited" a manager from the previous owner. Information on manager turnover in the NBA supports the idea that new owners engage in stronger monitoring: within one year of an ownership change, 48 percent of pre-existing managers are replaced. Overall, the results of our study suggest that managers deliberately use their external social ties to pursue goals other than team performance maximization.[5]

A unique feature of the institutional environment of our data allows us to address potential concerns about endogeneity bias as a source for our finding. That is, players may either be hired in the off-season period between two seasons, or after the beginning of a new season. To avoid any feedback from team performance at the beginning of the season on subsequent hiring decisions, we conduct another analysis, in which we focus only on a team's use of off-season tie-hired-players. Based on this approach, we still find a negative performance effect of tie-hired-players, and that this effect stems from tie-hired-players that the manager acquired under weak monitoring. Even when we acknowledge that off-season tie-hired-players may be influenced by a team's performance in the previous season, we find that the performance effect of tie-hired-players is negative and depends on whether they have been acquired under weak or strong monitoring by the owner. Overall, we show that adverse selection of teams and managers into the use of tie-hiring procedures cannot fully explain our findings.

While the setting of this analysis is unusual, the results of our study have fairly broad implications. Several studies in the management and economics literature reveal that employees' external social ties influence their decision-making on behalf of the firm, for example, in connection with hiring (Fernandez and Weinberg, 1997; Williamson and Cable, 2003) financing

[1] Bandiera et al. (2009) and Beaman and Magruder (2012) argue that social networks create network-based incentives, which lead to a form of social transfer between network contacts. This explains why individuals prefer to recommend their less able family members (instead of more able weak ties) as workers to firms. Similarly, Lawler and Yoon (1998) argue that interactions through social ties lead to greater positive emotions than interactions with strangers. Such private benefits for decision makers may distort their decision-making on behalf of the firm, and may lead to an excessive reduction in the universe of potential transaction partners, which causes a suboptimal match of resources and firms. Note that this idea is essentially an agency argument.

[2] There exists a growing literature that uses sports data sets to study general economic and organizational phenomena, because they provide statistics that "are much more detailed and accurate than typical microdata samples" (Kahn, 2000; p. 75). Examples include Pfeffer and Davis-Blake (1986), Walker and Wooders (2001), Berman et al. (2002), Chiappori et al. (2002), Barden and Mitchell (2007), Moliterno and Wiersema (2007), Holcomb et al. (2009), Aime et al. (2010), Price and Wolfers (2010), Pope and Schweitzer (2011), Berger and Pope (2011), Kocher et al. (2012), Massey and Thaler (2013), and Bartling et al. (2014).

[3] In the remainder of this paper, we use the simple term "manager" to refer to a team's general manager.

[4] A small existing literature in finance and strategic management relies on investor reactions to decision announcements as a "jury verdict" to measure the performance effect of tie-influenced decisions (e.g., Fracassi and Tate, 2012; Tian et al., 2011; Ishii and Xuan, 2014). However, the announcement of, e.g., merger decisions may cause substantial disagreement regarding the performance effect among investors (which are also known to exhibit a number of systematic valuation biases). This evaluation problem disappears in our research setting: at the end of a game, there can be no doubt which team won.

[5] Importantly, we do not find evidence in our data that ownership changes reflect a previous reduction in team performance: team winning percentage in the year before the arrival of a new owner (46.3%) is virtually identical to the team's average winning percentage in all previous years under the original owner (46.8%).