

THE ELITE AND THEIR BOARDS OF DIRECTORS*

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Abstract

Most of studies on corporate governance are based on the Anglo-Saxon view. However in France the majority of the top managers graduate from Ena and Polytechnic. Belonging to one or the other of these two clans, with the underlying link to the civil service, can have serious repercussions on the system of corporate governance. The clan tries to increase their power in the firms. In order to do this, it needs to control firms' leaders, but also the board of directors. The control of the board allows the system to master all shareholders' objections. It is also a means to widen its influence. This study proposes an analysis of the links between the characteristics of leaders and boards as well as the consequences of this control of the clan on the performance of the firm.

Keywords: corporate governance, clan, entrenchment

Introduction

Discussions concerning corporate governance, these based on numerous investigations by Anglo-Saxon authors, have become increasingly frequent in France in the last five years¹. It should be stressed, however, that French capitalism contains particularities imparted by its mode of governance.

An essential aspect of this is the nature of the directors of major companies. Bauer & Bertin-Mourot (1995) find that two-thirds of all French top managers are integrated directly into elevated management posts. Over 50% of these have worked for no more than four years within the company before taking over as managing director. This situation is not reflected in other European management models where experience and knowledge of the business are considered essential for CEO position. (Bauer & Bertin-Mourot, 1996)

Another aspect of French corporate governance may be found in the cultural origins of France's management elite. More than 50% of all French companies CEOs are graduated from Polytechnique Institute (familiarily referred to as "X") and of the Ena (referred to as énarque(s)) (23% for Ena and 27% for X). This is far from being insignificant and Bauer & Bertin-Mourot (1996, 1997) stress that an executive's initial training defines his managerial style. What is more, French business law allows corporate chairmen to preside over meetings of the Board of Directors. The accumulation of two executive functions carries heavy consequences for Corporate Governance. A company CEO, acting as chairman of the board of di-

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¹ For a detailed presentation of corporate governance, consult Charreaux et al (1997), Caby & Hirigoyen (1997), Shleifer & Vishny (1998) as well as Maati (1999).

rectors, wields exceptional power; article 113 of the law of 1966 states that, “the chairman of the Board of Directors is vested with the most far-reaching powers to act in all circumstances in the name of the company”. Corporate Governance principles underline the importance of the board as a supervisory body permitting the limitation of conflicts between shareholders and management. The importance of these internal controls as well as the reports made by Cadbury and Vienot has brought forth numerous discussions.

Having taken into consideration observations that give French Corporate Governance its special hue, we propose in this study to investigate the role of internal control played by the board of directors. We will concern ourselves particularly with boards comprised of Polytechnique and Ena graduates in order to detect the influence of networks over the organs of corporate control. We will suppose that systems applicable to them differ notably from classical systems². The result of belonging to a powerful network, whose influence is felt as much in the private as in the public sector, conditions the power of decision-makers regarding the company’s partners and the independence of surveillance mechanisms regarding managerial teams. The objectives of the members of these networks may be contrary to those of the shareholders of companies they manage³. We will then suppose that managers originating in the elite (graduates of the Polytechnique or the Ena) can influence, even paralyze company supervisory systems in order to use these resources to further the interests of the networks to which they belong [Paquerot 2000].

This study will focus of the year 1995 as it marks the beginning of the Anglo-Saxon type Corporate Governance movement in France. It will show how the particularities of the French situation, at that period, influenced the way the French firms applied the rules of the Corporate Governance. This is particularly important as it conditions the actual situation.

First, we will study the logic of networks. In the second part of this study, we will approach the effects of the competition between networks in the paralysis of control systems and the phenomenon of entrenchment. In part three, we will analyze the motivations for the control over boards of directors of the companies directed by these networks. In part four, empirical studies will allow us to test hypotheses advanced in our theoretical exposé. Finally, conclusions will be drawn in the last part of our study.

The logic of networks (of influence)

Research by Morin [1997] and Bauer & Bertin-Mourot [1997] shows a strong concentration of Ena and Polytechnique graduates in French companies. The first study underlines the financial links and the influence of networks in major French companies, notably through cross holdings. The second study highlights the concentration of power in the boards of directors of CAC 40 companies. In both cases, results show strategies clearly designed to increase the power of networks over these companies.

The power of networks: between power and the logic of the clan

The privileged position of “X” (Polytechnique graduates) and “Enarques” (graduates of the Ena) in the centers of economic and political decision-making confirm their influence. Indeed, the proportion of this élite at the head of important French companies has progressed con-

² The absence of significant results concerning the efficacy of classical surveillance systems in French studies [re. Alexandre and Paquerot, 2000 and Mtanios & Paquerot, 1999] justifies considering sociological variables concerning managers, directors and other partners in the company in order to better understand the independence of auditors as regards managerial teams.

³ This conflict of interest relates to the classic problem of the separation between property and control [Berle & Means 1932, Jensen & Meckling 1976].

stantly since 1960⁴. Thanks to posts in the most important French firms, the graduates of these two schools are capable of imposing their power by the intermediary of a clan structure. First, we will analyze the principle of power; we will then study the behavior of the clan.

Power. Dahl [1957] defines power as “the capacity to have someone do something that they otherwise would not have done”. Power can be related to a resource or a social relation that permits the exercise of influence over another person or situation. There are numerous sources of power; Morgan [1989] counts 14 as the most important⁵. In the greater number of organizations, power is of an autocratic type or shows a mix of autocracy and democracy, which allows a leader to exercise stable, well-defined authority. In a managerial type of system, however, power can only be democratic because control belongs, in theory, to shareholders. Here we face the dilemma of all managerial companies which must delegate the authority of shareholders and the management of the company to an individual or a group of individuals.

In the research concerning Corporate Governance, the idea of power is understood through the CEOs-board of directors relation. A first school of thought, stressing organizational behavior⁶, suggests that the degree of power held by the CEO influences the composition of the board via co-optation phenomena. An adequate and judicious choice of directors should allow a manager to effectively reach his personal objectives. Of course, it remains to be seen if the personal interests of the manager coincide with those of the shareholders. The power of the leader over the choice of directors sends us back to research concerning the entrenchment of the CEO. Another trend, stemming from organizational sociology, refers to existing social links between directors and managers. The composition of the board shows the nature of the links between the members of this elite class, it underlines inter organizational dependency⁷. A third and more financial vein asks the question about directors’ remuneration. These persons seek to obtain a reputation of “good” directors⁸ in order to increase their power of financial negotiation⁹. A final vein based on the theory of classes, blends intra and inter-organizational dynamics¹⁰. The managers-board relationship is influenced by the directors’ experiences on other boards, which affect the company’s decision-making process. Social relation unifying directors serve “to direct managerial comportment, to socialize new directors to the culture (of capitalists) and to control deviant behavior”¹¹.

We find all or part of these four veins of thought in the behavioral analyses of Ena and X graduates. Managers-board relations are facilitated by the same origins. Close social links avoid behavioral deviation on the part of directors and/or the leader. The network formed by the élite draws its power from formal knowledge and authority. Indeed, the Ena and X are known for training efficient, high-level, intellectual civil servants, who benefit from the not negligible charisma of these institutions. In the actual context of economic and technological change, companies need information in order to remain competitive. But, Pfeffer [1981] points out; “power is specific to context or to relations. A person is not powerful or weak in general, but only in relation to other social players in a specific relationship”. Power, then,

⁴ Bauer & Bertin-Mourot [1995].

⁵ Formal authority, control of rare resources, use of the structure and the rules of organization, control of decision-making, control of knowledge and information, control of frontiers, capacity to deal with incertitude, techniques control, interpersonal alliances, network and control of “non-formal organization”, control of contra-organizations, symbolism and management of signification, sexes and management of relations between the sexes, structural factors which define the framework of action and power already in place.

⁶ Herman E. [1981], Vance S.C. [1983], Mace M.L. [1971.]

⁷ Pfeffer J. & Salancik G.R. [1978], Zajac E.J. [1988].

⁸ A “good” director is a person who actively defends shareholders’ wealth.

⁹ Fama E.F. [1980], Fama E.F. & Jensen M.C. [1983].

¹⁰ Zajac E.J. & Westphal J.D. [1996].

¹¹ Palmer D. [1983].

implies of relation of dependency. This type of elite diploma creates, in the company, a relationship of dependency and confers the legitimacy upon which the power of these graduates is based. This situation poses the well-known problem of inter-organizational dependency, but also that less known problem of intra-organizational dependency.

Application of a particular organization: the clans. Graduates of the Ena and the X form a specific group which is born in the draconian process of selection at entrance and which translates out to a small number of candidates. This selectivity (which can be considered tantamount to a barrier at the entry to a market) permits graduates to build a social network. Using the definition formulated by Morgan [1989], we can define a social network as “a non-formal organization in which individuals interact in order to satisfy different needs of the social order”. When the network unites individuals of the same social-cultural identity, it can be considered as a clan. Clan-type behavior has been closely studied by Ouchi, Mayo & McGregor. These authors define the clan as a culturally homogenous organization, in which each member shares the same values and objectives. Clan groups are made up of members with a professional itinerary and specific training through which they identify with one another¹². This similar past renders the clan impenetrable to any person with different intellectual training. In this way, internal conflict is minimized. In order to make personal motivations better coincide with those of the organization and in this way to avoid eventual conflicts of interest, an increased socialization of clan members is put in place. This is characterized by the fact that new arrivals are few in number, which maintains internal cohesion and minimize socialization costs¹³. This weak turnover creates solid long-term relations.

The networks of Ena and X graduates assimilate easily into these organizations because the behavior of these graduates is strongly influenced by the ties created during their studies; this is what Charreaux & Pitol-Belin [1989] call the theory of social cohesion. What is more, these two schools have a long history of training the top managers of the public sector in France and a relatively stable composition, which allows the clan to institutionalize social knowledge. The particularity of these graduates is a shared macro-economic vision of the company and its functioning in markets. Because they are often “parachuted” to important managerial positions, their space-time references are based in the state culture rather than in the company culture¹⁴.

The company then becomes a showcase for the spread of the clan’s power and at the same time, a field for conflict for the increase of power for any competing clan.

The use of companies by the network. The role of the networks in the management of major French companies is all the most important. We will try to determine their objectives and the roles they give to companies in their strategy of conquest.

The company: a resource for networks. Paquerot [2000] remarks that the company may be considered as a mean for the network to increase its power and to fight the growth of competing networks. This supposes that the resources of the company are not necessarily allocated in a manner that will optimize shareholders’ wealth. The conflicts of interest resulting from such a state of affairs will require the network to develop a strategy of entrenchment in the company¹⁵ in order to limit the prerogatives of shareholders and, in particular, their objections to the choice of resources allocation made by directors who are network members. The network must, at the same time, assure at least a minimal company performance in order not to detract from members’ collective reputation and to thus promote competing networks.

¹² The term is used here in the sense of “belonging”.

¹³ Wilkins A.L. & Ouchi W.G. [1983].

¹⁴ Bauer & Bertin-Mouroit [1996].

¹⁵ For a presentation of the entrenchment theory we can refer to Shleifer & Vishny [1989, 1991], Morck, Shleifer & Vishny [1990], Castanias & Helfat [1992], Hills & Jones [1992] and Paquerot [1997].

From this viewpoint, the company is managed to optimize its utility to the network while necessarily offering at least minimal viability for shareholders.

Nonetheless, Paquerot [2000] observes that the performance adjusted to risk is significantly inferior for companies managed by personnel from the Ena or the Polytechnique. This result confirms the hypothesis by which companies belonging to networks do not optimize shareholders' wealth.

Such a situation supposes that the organs for decision-making and company control must be controlled in order to use company resources for the needs of the network.

The company: a place for the development of the network. French capitalism is characterized by cross holdings methods, which allows a company to become a financial resource and also a source of power. This system permits the creation of beneficial alliances in the control of voting rights, thus neutralizing a portion of outside shareholders. This neutralization is so much the bigger insofar as capital is for the most part "tied up"; the manager may then wield power by internalizing it. Morin [1997] shows that French capitalism can be broken down into two interrelated components. The first group is "cored" by the Société Générale, the AGF, Paribas, Alcatel Alsthom and Vivendi linked by a system of mutual interest. In the second, we find cross holdings between the BNP, Elf, Saint Gobain and Suez. In these two groups, we see that over 50% of CEOs are graduates of either the Ena and/or X (60% for the first group and 75% for the second).

Thus comprised, the network is a completely homogenous organization as much in its composition as in its behavior. The interests, whatever form they may take, permit the maintenance of this homogeneity in such a way as to resist all exterior pressure, be it political, social or financial.

It should also be mentioned that certain sectors seem more strategic than others for the networks. The banking and insurance sectors benefit particularly from favors dispensed by the networks because they are frequently in contact with businesses in their role of investors or, more globally, as financiers. The control of such an important resource constitutes an important source of power for the networks and facilitates their development in companies.

The objectives of the networks differ from those of shareholders. The networks use companies as resources to augment their power. This objective is not necessarily compatible with the optimization of the company from the point of view of a shareholder or the company's various partners.

Thus, the necessity of using company resources to conquer new companies and augment the power of the network may be contrary to the interests of shareholders. Morin [1997] clearly shows that networks use the financial capacities of companies controlled to gain «territory» by investing in firms in which they wish to gain influence.

In the same way, the overlapping of the network and the dependency of the company towards the resources of the network limits the power of shareholders and entrenches the network in the company. The result is a growth of its power over the company's partners, corresponding to a situation of entrenchment. This allows the network to resist in the face of competing networks.

The effects of competition between networks: paralysis of control systems and entrenchment

Each of the two networks (Ena and Polytechnique) defines a clearly established discretionary space in the French economic landscape. This space is preserved at the price of competition for the control of different companies. This competition, as in any other economic market, takes the form of positions that are more or less monopolistic or the establishment of barriers

at the entrance. In the case of manpower, the use of barriers takes the form of means to minimize external control over management modes and/or by entrenchment phenomena.

A struggle for power and resources

Each clan is closed to every person issue of non-elitist training or from competitive training. The network has a double objective: maintain an already acquired position by closing it to all potential entry and increase its power by external growth. A struggle for power is then begun in order to control the company in its totality, meaning the control of resources and the control of politico-economic decision-making.

Competition between networks stimulates the entrenchment strategy of company directors. The control of resources is so much the more important in that the control of levers of political and economic decision-making is essential for the survival of the totality of the network and the success of its members.

This control must be complete in light of the fact that these resources will be the object of takeover attempts by competing networks. The interdependence of the network's members (financial links, board members, partners, customer-supplier relations, etc.) may render the situation difficult for the aforementioned when a strategic resource (or company) falls under the control of a competing network. This struggle thus pushes the network to become entrenched in order to preserve control of the company and the resources it represents. This entrenchment creates a system of collective self-imposed control influencing company decision-making.

Network entrenchment in companies thanks to multiple manpower

The strategies of network entrenchment are relatively classical; they consist of paralyzing control systems by raising the dependency of the company on its manpower¹⁶. The CEO entrenchment increases its power inside the company which creates an effect of aggravated dependency due to problems of asymmetry of information and internal and external resistance.

The asymmetry of information. Rajan and Zingales [1998] define the company as an assemblage of specific investments in which each combination is unique and cannot be reproduced instantaneously by the market. The increase in the number of network members in the company increases the asymmetry of information between the network and the company's partners. The more the network is present in high-level management and in the board of directors as well, the greater the asymmetry of information and the more the company is dependent on network members. The increase in relations with company stakeholders, themselves network members, further increases this dependency.

Overlapping manpower and network resources within the company increase the occasions where the independence of the company is compromised and where business partners are tempted to want to escape from the influence of the clan. The cost of escape is too high in terms of information, resources... In limiting alternative solutions offered shareholders, the networks reinforce their control over the company¹⁷.

Let us add to the asymmetry of information the possibilities of resistance from network members inside and outside the company.

¹⁶ Paquerot [1996].

¹⁷ Hills & Jones [1992].

Internal and external resistance. The networks are capable of putting in place a certain number of barriers at the entry in order to dissuade competing networks from trying to take control of companies that belong to them.

Thus, the rise in the cost of influence like those defined by Milgrom and Roberts [1992] that constitute an effective solution to dissuade partners from seeking managerial teams not belonging to the network in place. The implicit contract established between the companies belonging to the network can help their resistance when faced with takeover attempts from competing networks.

The informal links between the network's resources, inside and outside of the company constitute an important source of income. Their disappearance could cause grave difficulties for the company and for the competing network which attempts a takeover.

Also, the occupation of the most strategic posts in high-level management permits the paralysis of competing network strategies, because the changeover in the network supposes a loss of information, know-how and of important informal relations. The disappearance of this strategic manpower can do great damage to shareholder wealth and may incite the aforementioned to support the network already in place.

Informal contracts¹⁸ with salaried employees, customers, suppliers... can also cause these parties to support the network.

The entrenchment of the network in the company is the means to effectively use and/or augment one's power. Each and every member of the clan works toward the attainment of network objectives. This behavior is explained by the very philosophy of the clan that melds the interests of each individual with the interest of the clan. It is, indeed, in the interest of every member that the network be very strong, for they benefit directly.

The benefits of belonging to a network: sufficient payback?

When an enterprise and its relations belong to networks it finds itself with an important source of wealth for the totality of its partners. Thus, relations with the State can be extremely fruitful in terms of markets overt, influence, information... The deep involvement of the French State in the economy justifies recurring to resources that benefit privileged relations with this partner. The networks benefit from important contracts offered by administrations and allow for the obtention of rare resources that depend on the State. As Bauer and Bertin Mourot [1995] note, graduates of the Ena and the Polytechnique represent 50% of the management of the 200 most important national companies. Consequently, besides privileged relations with the state, networks also benefit from important relations to private business. These relations can notably help in accessing potential markets, partnerships, information sources, social networks, and financial or industrial partners...

From this standpoint, the manpower of the networks is rich and can be an important source for the creation of value for the businesses in question. The participation of networks in the life of a company represents a major interest for owners¹⁹. But the price paid by shareholders is the loss of control over company management.

The competition between networks is not without consequence on the functioning of the company, because it induces phenomena of entrenchment. However, the control exercised by the board of directors over company management is not to be neglected. We propose, in part three, to study strategic control of the board established by the networks.

¹⁸ On the efficacy of informal relations and networks it is interesting to consult Breton & Wintrobe [1982], Charreaux [1990].

¹⁹ Castanias & Helfat [1991,1992].

The protection of network resources: the control over the board of directors

The board of directors plays an important role in the company's strategic policy. Control over the board is a privileged means of controlling shareholder discontent and to increase the power of the network within companies they control. Indeed, the board controls company policy and names the manager. It becomes an open door to the network and a means to increase and reinforce its power.

The board of directors: an essential and strategic body

The existence of distinct relationship between owners and management of a company confers legitimacy on the board of directors that in turn plays an important role in the system of Corporate Governance. The board is a body intended to correct the inefficiencies of external controls. Its initial function is the management of relations between shareholders and management. The Vienot report, for example, defines the board of directors through the four following duties:

- ◆ definition and establishment of company strategy
- ◆ designation of social representatives authorized to manage this strategy
- ◆ monitoring company management
- ◆ control of the quality of information conveyed to shareholders

However, for Peter Ducker [1957], the board of directors is “a means of control, evaluation and appeal. It becomes active only in periods of crisis and then only for eliminating directors who have failed in their duty or to replace them in case of resignation, retirement or death. Once the replacement is made, the board returns to its function as a controlling body”.

The directors act in the name of the company's owners²⁰. To accomplish their mission, far-reaching powers are conferred on them. The prerogatives of the board have more impact on the management of the company if its manager is not the owner. However, in real life, the board of directors of a managerial company is more or less active in the monitoring role that is incumbent on it. Its theoretical role is to discipline managers in order that they search constantly to optimize the value of the company. Discipline may be understood as surveillance or as surveillance and sanctions. Sanctions by directors amount to “demoting” the director or to requiring him to modify strategy which is judged not in the shareholders best interests. In order to exercise efficient control over managers, directors must be independent of management teams and their interests should be aligned with those of shareholders. The presence of directors belonging to the same clan as managers gravely compromises the preceding two conditions and in consequence the efficacy of audits realized.

Control of the board

The board of directors, as internal control body, can be an obstacle to the growth of the power of the network. Its functions are wide ranging, the nomination of the director places it at the

²⁰ The OECD published a list of principles and codes in 1999 in an attempt to unify practices of Corporate Governance. Concerning the role of the board of directors, it stipulates: “The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

1/Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.

2/Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.

3/The board should ensure compliance with applicable law and take into account the interests of stakeholders.”

heart of the clans' power struggle. It can also be an open door in a company directed by a member of an opposing clan and/or a means of growth.

The nomination of directors. One of the fundamental functions of the board of directors resides in the power to appoint executives and to revoke their mandates. The control of this body by the network permits it to control the naming of directors. This control is essential for the entrenchment of the network in the company because it permits its maintenance of power in the company. What is more, it should be noted that executives make a career in the network and not in the companies. Paquerot [2000] notes that the mandates of directors originating in the élite are shorter than those not having graduated from the Ena or the Polytechnique. To allow this mobility in the companies of the network, it is important that the succession of directors be controlled by the networks.

The probabilities of succession between members of the same network are very high [Paquerot, 2000] and suggest that the top managers control the elections for directors in the companies they manage. Such results suppose, in consequence, the total control over the board of directors, the strategic decision-making body concerned with the nomination of directors. He underlines the dependency of companies as regards the network. This phenomenon is reinforced by competition between networks.

The locking-up of decisions for the allocation of resources for network companies

As we have seen previously, decisions for allocations of resources can be contrary to shareholders' or company partners' interests. The role of the board of directors is to assure that decisions are made in the interest of shareholders, and to constrain management to the best decision for the owners of the company. Conflicts of interest between network-member directors and shareholders should be handled by the board of directors. This body, in theory, has at its disposal the legal means necessary for the protection of shareholders' rights. The strongest sanction consists of the firing of the management team when this group does not manage the company in the best interest of its owners. In order to avoid such a situation and the adverse publicity to the collective reputation of its members, the network should be able to control the actions and reactions of the board of directors.

The locking-up of this body permits a large margin of maneuver in which to use the resources of the company toward the interests of the network. By blocking recourse at the level of the board of directors, the network leaves little possibility for protest by shareholders against decisions concerning resources allocation.

In addition, the board of directors is a body essential in the collection of information for shareholders. By controlling this information, the networks may increase their power over the owners of the companies owing to their control over strategic information. The asymmetry of information remains the most efficient and least costly entrenchment strategy for directors. We may add that in case of major problems in company management, the control over the principal monitoring body permits the increase in the asymmetry of information with stakeholders and to preserve the reputation of the network. This phenomenon is reinforced by competition between networks.

A phenomenon aggravated by the power struggle between networks. Bourdieu [1989] notes that competition between the Ena and the Polytechnique appeared at the moment of the creation of the former institution. Polytechniciens rapidly became worried over the progression of énarques in political and economic centers of decision-making. Bauer and Bertin-Mouroit [1995] remark, after observing the directors of the 200 most important companies in France, that the proportion of Ena graduates in high-level management progresses more rapidly than the proportion of polytechniciens.

The power struggle between these networks aggravates entrenchment strategies carried out by the élite within companies and particularly within boards of directors, the privileged

center of power and decision-making. Control over the board of directors permits to counter takeovers formulated by competing networks, by limiting direct objections to company management carried out by the management team in place. In addition, the asymmetry of information as regards competing networks may be increased through limiting or prohibiting their access to the board. This strategy therefore supposes the occupation of the board of directors by members of the network of directors affiliated to the network. By limiting competitors' access to information, the network protects itself against takeovers. We may add that control over the board of directors greatly limits probabilities of a takeover by a competing network.

Control over the board of directors is in fact the most economic means of controlling the company. Other solutions are far more costly, including hostile takeovers that require large financial means²¹.

The board of directors: a supplementary resource for the network

The board of directors can represent a few additional opportunities for the network. On one hand, it can act as an entry into a company not already controlled by a competing network, and on the other, it can act as a means for increasing the network's share capital.

The board of directors: an open door to the network. The board of directors can serve as an opportunity for the networks to enter a company, because it is the principal center for power and decision-making. The entrance of the network into the board of directors procures numerous advantages for shareholders, because network-member directors are privy to information, resources and manpower that may benefit the company. The control of the company may be acquired through the control of its board of directors or through the introduction into the board of the network's manpower. The board of directors is the ground most fertile for a takeover, for it is here that managers are proposed to shareholders and where management is controlled. Consequently, the control of the board of directors implies, eventually, control over the nomination of managers on condition that the company's partners are not able to impose the management team of their choice²². By entering the board of directors, the networks make the company available to new partners. These new partners, who offer their resources, may also influence management choices supporting the strategy of entrenchment of the network in the company.

The shareholders may cause the networks to compete against one another in order to incite the networks to furnish more wealth. The presence of members from the Ena and the Polytechnique in certain boards of directors illustrates the on-going power struggle between these two networks for control of the resources of certain companies.

The board of directors is an opportunity to enlarge the network. Boards of directors can also represent resources for networks. Indeed, the board of directors is a privileged point for gathering precious information on the company, its partners, its sectors of activity... The networks need this type of information in order to be efficient and control a great number of resources. The control of the board of directors allows, on the one hand, access to information and, on the other, to limit its circulation outside the network in order to maintain a competitive edge with the company's partners.

But the board of directors can also offer the network an opportunity to increase its share capital, by appointing directors who are not fully members of the clan but who have a favorable leaning towards it and have great influence on other partners.

Access to privileged information allows non-network directors to increase their influence and their manpower. Stamford-Pichard [1997] notes that directors can find themselves

²¹ The takeover of Elf (a company headed up by an énarque treasury official, but long managed by Xs) by Total-Fina (managed by an X) illustrates this approach.

²² As can be the case in the presence of majority shareholders.

indebted to executives or to persons who appointed them to the board of directors because they consequently enjoy increased manpower (and, in particular, share capital). In controlling boards of directors, the networks may thus increase their influence by generating increased share capital. This theoretical study underlines the importance, for the network, of simultaneously controlling the company's management team and its board of directors. Total control over the monitoring systems established by the company's governing systems allows the network to impose and later reinforce its power. In the following section, we will test the totality of hypotheses put forward.

The network and the boards of directors: the auditor controlled

We will interest ourselves with three essential aspects during this test.

- ◆ The relation between the leaders' manpower and that of directors
- ◆ Competition between networks
- ◆ The impact of networks on company performance

Sampling description

The sample is comprised of 123 publicly traded French companies. Leaders and directors are classified according to their educational and professional itinerary, taking special note of former students of the Polytechnique and the Ena. This research concerns the year 1995. Performance of companies is estimated on a Sharpe ratio calculated on the year 1995. The reduced size of the sampling has led us to use non-parametric statistical tests.

The relation between executives' manpower and the composition of their boards of directors: the questionable independence of directors

Let us suppose that the control of the resources of a company is accomplished in part through control of the company's board of directors. This supposes that the manpower of the board of directors should be correlated to that of managers, in order to support these managers, and in order to ensure that the board is not occupied by members of a competing network. Such a strategy tends to eliminate the independence of directors as regards managers and thus compromising the efficiency of their supervisory efforts.

In the same way, competition between networks allows us to suppose that the top managers are incompatible, or more exactly, that there exists a negative correlation between the manpower of managers from the Ena and those directors originating in the Polytechnique (and vice-versa)²³.

This line of reasoning brings to test the following hypotheses:

H1: The manpower of leaders is correlative to the manpower of the board of directors

H2: The members of the élite are not compatible amongst themselves

H0: There is no correlation between the manpower of leaders and that of their boards of directors.

²³ The phenomenon should be stronger if the company was or still is linked to the State. This conditions the seniority and the power of one network or the other in decision-making bodies. For companies where the conquest by the networks is more recent (Eg: Accor), expected results should be less striking.

Table 1. Relation between leaders and the composition of the board of directors

		Board Domination			Total
		Board with neither X nor Ena	Board with Ena > X	Board with X > Ena	
CEO	Ena	4	9	2 ²⁴	15
	X	5	3	24	32
	Other	20	30	26	76
Total		29	42	52	123

For CEOs from the Polytechnique:

◆3 CEOs (9.5%) are controlled by the board of directors where the Ena network is greater in number than that of the Polytechnique.

◆5 CEOs (15.5%) are controlled by the board of directors in which there are no directors from X or the Ena.

◆24 CEOs (75%) are controlled by the board of directors where Xs are in the majority.

For CEOs from the Ena:

◆2 CEOs (13.5%) from the Ena are controlled by the board of directors where the network of X is greater in number than that of the Ena

◆4 CEOs (26.5%) from the Ena are controlled by the board of directors where there are no Xs or Enas.

◆9 CEOs (60%) from the Ena are controlled by the board of directors where the Ena network is in the majority compared to that of X.

In the majority of cases (over 60%), leaders from X or the Ena are controlled by boards of directors in which their network is in the majority compared to competing networks. Only 16% of the companies in the sampling have no director either from the Ena or the Polytechnique.

Table 2. Composition of Board and leaders' profiles

Leaders' profile		Percentage of Ena directors	Percentage of X directors	Percentage of X or Ena mandates ²⁵
Ena CEO	Average	0.24	0.25	0.52
	Minimum	0.00	0.00	0.09
	Maximum	0.46	0.50	0.86 ¹⁶
X CEO	Average	0.16	0.28	0.48
	Minimum	0.00	0.00	0.17
	Maximum	0.54	0.50	0.92 ¹⁷
Other CEO	Average	0.11	0.11	0.25
	Minimum	0.00	0.00	00
	Maximum	0.63	0.58	0.71 ¹⁸

The preceding table shows that boards of directors for Ena leaders are comprised of 24% énarques and of 25% polytechniciens¹⁹.

These percentages are 16% and 28% for directors from the Polytechnique²⁰ and 11% for the two types of directors when the directors are neither from the Ena nor the Polytechnique.

²⁴ Including Eurotunnel. The technical aspect justifies the presence of Xs, but the financial aspect requires the Ena's banking and financial network.

²⁵ Mandates of leaders, directors or members of the supervisory board.

¹⁶ Crédit National

¹⁷ Générale des eaux

¹⁸ Cie Bancaire and CEP communication

¹⁹ This surprising result can be explained by the fact that énarques "hunt in the same reserves" as Xs [Bauer & Bertin-Mouroit 1995], meaning companies which, historically, have been controlled by Polytechnique graduates. The conquest of the company is accomplished through the conquest of the board of directors.

Table 3. Kruskal-Wallis tests

	Leader's profile	N	median
% Enarque directors	Ena	17	89.59
	X	33	69.85
	Other	76	54.91
	Total	126	
% X directors	Ena	17	81.41
	X	33	88.44
	Other	76	48.66
	Total	126	

Table 4. Significance of non-parametric tests

	% Ena directors	% X directors
Khi-deux	14.649	32.945
Ddl	2	2
Asymptotic signification	0.001	0.000

These tests show significant differences in the composition of boards as regards the origins of the leaders.

- ◆ Enarque CEOs promote énarque directors.
- ◆ Polytechnicien CEOs promote polytechnicien directors.

These results confirm the hypothesis of the control of the boards of directors by the networks to which their leaders belong. The results seriously put in question the independence of boards of directors regarding management. The significant presence of directors belonging to the same network as the management allows this latter group to manage the company in the best interests of the network, not necessarily optimizing shareholder wealth. This presence assures the network that its members will be re-elected to head the company at periodic changes of executive company head. However, the hypothesis of the incompatibility of the elite is not confirmed. 42% of companies in the sampling have access to both networks. This is explained by the fact that the boards of directors are the ideal place for takeovers by the respective networks. The composition of the boards expresses the conflicts which take place within the companies and the struggles for influence which oppose the Ena and the Polytechnique²¹. The composition of the board of directors before a change of management also seems to be a good indicator of the manpower of the future managerial team. Thus, in the case of Accor, before the appointment of an énarque CEO, the board of directors contained four énarques and only one X. As the company was never directly linked to State activities, the networks are not implanted since its creation, and it represents new territory for the networks and its conquest will be realized in its board of directors because this represents the least costly means of takeover.

In the same way, the board of directors of the Compagnie Générale des Eaux, directed by an X, had six polytechnicien directors and five énarque directors before the appointment of a new director. Jean-Marie Messier, present group director, is the result of this particular

²⁰ Given the progression of the competing network, Xs seem to have adopted a more defensive strategy and tie up their positions in their boards of directors more tightly by limiting Ena access and reinforcing their presence on the board. It should also be noted that graduates of the Polytechnique are three times more numerous than Ena graduates. There are more Xs than énarques.

²¹ It is also important to remark that the tax inspectorate can serve as common ground between the two networks because the best students of both schools may enter this branch of French administration directly upon graduation.

composition because he is at the same time polytechnicien, énarque and general auditor of the Treasury²².

Control of the board of directors and its consequence on the firm's performance

The control of the board of directors supposes an absence of shareholder control on management. Conflicts of interest between the network and shareholders cause the former to optimize their utility to the detriment of the interests of the latter. The internal control that networks must exercise on their members in order to preserve their collective reputation and their share capital does not necessarily allow for an alignment with the interests of shareholders. At best, this will bring network-member directors to manage a company with an objective of at least minimal performance for the company in order to preserve the reputation of the network.

We will then test the following alternative hypotheses:

H3: The performance of companies controlled by the top managers (in terms of boards of directors and leaders' manpower) is not as good as that of other companies.

H4: There is no difference in performance between companies controlled by the networks and other companies.

The last hypothesis supposes that networks manage companies with the single constraint of minimal profitability for shareholders in order to preserve their members' reputation.

Description of performance tests. In order to test the impact of the top managers on the boards of directors, companies were separated into two groups.

Performance adjusted to risk is measured by a Sharpe ratio for the year 1995. The companies whose Sharpe ratio for the year 1995 is superior to the mean of the whole are considered profitable, the others are considered unprofitable. Non-parametric tests of mean differences were conducted in order to determine if significant differences existed in the composition of the boards of directors, particularly as regards énarques or Xs.

Test results. The following tables show test results.

Table 5. Efficacy of directors from the Ena or X (tests by Mann and Withney)

Rank	Companies	N	Average Rank	Total Ranks
% Énarque Directors	Unprofitable	47	45.95	2159.50
	Profitable	47	49.05	2305.50
	Total	94		
% X Directors	Unprofitable	47	45.74	2150.00
	Profitable	47	49.26	2315.00
	Total	94		
% X or Ena directors	Unprofitable	47	45.01	2115.50
	Profitable	47	49.99	2349.50
	Total	94		

Table 6. Significance of tests

	% Enarques directors	% X directors	% X or Ena directors
U of Mann-Whitney	1031.500	1022.000	987.500
W of Wilcoxon	2159.500	2150.000	2115.500
Z	-0.570	-0.633	-0.885
Asymptotic Signification (bilateral)	0.569	0.526	0.376

²² It should be confirmed if the énarques on the board of directors of Vivendi are not themselves members of the tax inspectorate.

These tests do not show significant results and do not permit the corroboration of H3. However, the hypothesis of management under the constraint of minimum profitability seems to be confirmed. Companies whose boards are controlled by networks of Ena or Polytechnique graduates are not less profitable than other companies. Nor is their performance better than that of other companies, which makes the popularity of managers and directors from these networks in French companies puzzling. For the presence of such directors strongly influences the naming of leaders and supposes a loss of shareholder control over management.

Conclusions

The understanding of the French corporate governance systems of publicly traded French companies requires an understanding of the workings of the networks of graduates of the Ena and the Polytechnique and knowledge of their strategies. The classical monitoring systems, notably the board of directors, cannot function properly when dependent on these networks because the independence of auditors is a condition essential to their efficiency. In addition, conflicts of interest between shareholders and networks push the latter group to forge ahead with programs of conquest for boards of directors, the companies privileged center for the exercise of power. Competition between networks incites them to develop strategies of entrenchment. To better understand interaction between networks and control systems, the financial links developed between networks and the companies they control must be understood. With power in the board of directors and financial interests in the companies, the networks' control leaves little room for shareholders' opinions. However, the necessary internationalization of companies and their need for foreign capital and especially for powerful and independent shareholders (pension funds) should modify the influence of these networks on French companies. This study, conducted for the year 1995, should be completed with a dynamic study in order to determine the force of change.

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