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Business Ties & Investor Power: Activism and Control in the French Context

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Abstract

Despite their growing equity stakes, influence, and access to private information, institutional investors in France do not systematically exercise active control over portfolio firms. This study reveals that business ties between institutions and corporations significantly constrain shareholder activism, fostering passivity. Using a sequential mixed-methods approach—19 qualitative interviews with senior executives and a cross-sectional survey of 119 financial institutions, we show that institutions maintaining substantive commercial/operational relationships exhibit markedly lower governance engagement than those with fewer ties. These relationships create conflicts of interest and reputational risks, disincentivizing institutional investors from challenging management. Our findings underscore how business dependencies reshape investor power dynamics and dilute corporate oversight in France's interconnected financial landscape.

Keywords: Institutional investors, Business ties, Shareholder activism, Corporate control, Conflicts of interest, Corporate governance, France.

Introduction

Globally, the past decades have witnessed rapid growth in institutional investors and a concurrent expansion of their equity holdings in corporations. Given their superior expertise and economic scale compared to most individual shareholders, this shift in ownership structure implies enhanced corporate monitoring. These influential entities—endowed with prestige and privileged access to private information—hold potential for more effective corporate oversight (Appel et al., 2016; Bebchuk & Hirst, 2019).

However, the governance power derived from significant capital ownership may be diluted by institutional investors' relationships with portfolio firms. Beyond equity ties, financial institutions and corporations (or their executives) often maintain multifaceted connections. For instance, an insurer may hold shares in a company that is simultaneously its largest client (Rouby Ravera, 1998), while equity stakes may involve non-aggression pacts or operational cooperation agreements (Brito et al., 2022).

Such relationships critically shape institutional investors' monitoring behavior as shareholders (Heard & Sherman, 1987; Iliev & Kalodimos, 2021). They create dependencies and conflicts of interest, compelling institutions to support management to preserve valuable business ties—ultimately weakening their oversight capacity (Sahut & Gharbi, 2011; Bona-Sánchez et al.,

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This article examines the nature of these ties and their impact on institutional investors' monitoring behavior. We first critique agency theory, which—despite explaining shareholder-manager dynamics—overlooks relational linkages that may disincentivize monitoring. Next, we analyze how business/commercial ties influence governance. We then present original French evidence on how institutional investors' ties with portfolio firms shape their monitoring behavior.

Critique of the Agency Theory

Agency theory has significantly advanced our understanding of stakeholder relationships within firms, emphasizing the need for principals to implement control mechanisms over agents (Charreaux, 2000). However, it faces criticism for overlooking dependency relationships between contracting parties. These ties critically shape agents' incentives to monitor principals (Goranova et al., 2021; Sauerwald et al., 2022).

Neglect of the Relational Dimension

Agency discourse inadequately addresses a fundamental aspect of managerial control: the relational dynamic between controllers and the controlled (Rouby Ravera, 1998; Ben Mbarek, 2003; Fiss & Zajac, 2022). This dimension encompasses the relationship between executives (or the firm) and those tasked with oversight. Here, the connection transcends formal contracts; it involves interpersonal bonds between "the managing individual" and "the overseeing individual" (whether director or shareholder), or organizational ties between firms and their monitors (Aguilera et al., 2021).

In this framework, the controller's interest becomes contested. Decisions are contextualized within their relationship with executives, implying a trade-off between ideal oversight and relational pragmatism. Controllers rationalize actions based on relational stakes—evaluating outcomes through the lens of relational coherence rather than abstract principles (Westphal & Zajac, 2013). Thus, control is a "situated act": shaped by preexisting contexts, relational stakes, and interests meaningful within the controller's social space (Rouby Ravera, 1998; Gond et al., 2022).

Rouby Ravera (1998) identifies a gap between agency-theoretic predictions and real-world control practices, attributing this to cultural, regulatory, cyclical, cognitive, or relational factors. While her work examines human ties, we focus on commercial and business relationships.

Property rights: Tools for Alignment or Opposition

Ownership confers power that can either oppose or align with incumbent management (Salancik & Pfeffer, 1980; Jiang & Kim, 2020). Independent institutional investors may challenge managerial preferences (e.g., compensation structures or governance practices). Conversely, dependent institutions bolster executives to preserve business relationships (Bona-Sánchez et al., 2017; Appel et al., 2022).

Empirical evidence confirms that institutionally affiliated investors more frequently support management proposals than unaffiliated peers (Assaf & Yishay, 2010; Iliev & Kalodimos, 2021). Thus, institutional ownership does not automatically lead to managerial discipline. Understanding investor-firm relational dynamics is key to explaining monitoring behavior.

Literature Review

Contemporary scholarship challenges agency theory's premise that institutional ownership concentration inherently strengthens corporate governance, revealing instead that business ties between investors and portfolio firms generate conflicts of interest that systematically suppress shareholder activism globally. Empirical studies demonstrate that institutions with commercial dependencies (e.g., creditor relationships, client contracts) exhibit reduced monitoring intensity in the U.S. (Klein & Zur, 2011), China (Jiang et al., 2020), and cross-nationally (Iliev & Kalodimos, 2021), driven by reputational risks that deter "troublemaker" labels (McCahery et al., 2016; Bona-Sánchez et al., 2017) and strategic complicity through shareholder working groups or sponsor mandates (Ginglinger & Hamdouni, 2023; PROXINVEST, 2023). These dynamics intensify in relationship-based economies like France, where interlocking directorships and concentrated ownership normalize *relational deference*, transforming institutions into "governance hostages" (Sauerwald et al., 2022; Goranova et al., 2021). Recent French evidence quantifies this gap: high-dependency institutions exhibit 32% lower oversight intensity than independent peers, underscoring how business entanglements reconfigure power dynamics (Ginglinger & Hamdouni, 2023). This necessitates theoretical frameworks prioritizing relational capital (Bourdieu, 1986) over atomistic incentives and policy interventions like sponsor-investor firewalls to disrupt dependency cycles (Aguilera et al., 2021).

Corporate oversight operates through multidimensional channels intersecting economic, social, and individual domains, where dependency relationships manifest as financial linkages (e.g., cross-shareholdings), business ties, human connections, or hierarchical dependencies. Focusing specifically on *business/commercial ties* between financial institutions and portfolio firms, these relationships create reciprocal entanglements—such as insurers holding equity in firms that are simultaneously their largest clients, or banks serving as both shareholders and creditors to the same company. This duality generates a critical governance dilemma: while active oversight could enhance portfolio value, institutions risk deteriorating lucrative business relationships essential to their revenue streams (Klein & Zur, 2011; Jiang et al., 2020). Consequently, control power diminishes as dependency intensifies—the stronger the commercial ties, the weaker the monitoring incentives. Empirical evidence reveals how this dynamic manifests: during proxy contests, tied institutions typically *exit* positions (via the "Wall Street Walk"), *align* with management to preserve relationships, or contain conflicts through supportive voting—collectively reducing activist success rates (Pound, 1988; Iliev et al., 2015). Managers strategically exploit these dependencies, pressuring tied shareholders under non-confidential voting systems to support anti-takeover measures (Heard & Sherman, 1987). Beyond immediate conflicts, institutions actively cultivate passive reputations to avoid scaring off current and future business partners, as activist labels threaten relational capital and incur reputational costs that stifle oversight initiatives (Black, 1991; McCahery et al., 2016).

Empirical analysis of business ties' impact on institutional investors corporate control behavior

Methodology

This study employed a sequential mixed-methods approach to examine how business ties inhibit shareholder activism in France. First, 19 in-depth interviews with senior executives from major banks, insurers, and asset managers revealed real-world governance constraints like strategic complicity and reputational filtering. These insights informed a subsequent quantitative phase where a cross-sectional survey of 119 financial institutions measured oversight intensity through a validated *CONT index* and business dependency via a *DEPEN scale*. Cluster analysis

grouped institutions by dependency level, and independent *t*-tests confirmed significantly weaker monitoring by tied institutions. The integrated design allowed statistical patterns to quantify activism gaps while interview narratives explained why these gaps emerge. The table below details both studies' methodological architecture:

Characteristic	Qualitative Study	Quantitative Study
Data Collection Methods	Semi-structured interviews	Structured questionnaires
Study Period	2024	2024
Sample Composition	23 financial institutions: <ul style="list-style-type: none"> • 8 insurance companies • 4 banks • 7 portfolio management firms • 4 mutual funds (OPCVM) 	119 financial institutions: <ul style="list-style-type: none"> • 22 insurance companies • 17 banks • 45 portfolio management firms • 35 mutual funds (OPCVM)
Data Analysis Methods	Content analysis of interview transcripts	Cluster analysis and mean comparison tests (ANOVA/ <i>t</i> -tests)

Table 1: Characteristics of Qualitative and Quantitative Studies

Results of the Qualitative Analysis

Our interviews revealed a critical insight: French institutional investors often prioritize business relationships over their duty to monitor companies they invest in. This creates a system where oversight is weakened. We identified four keyways this happens:

1. Major investors (like banks and insurers) sometimes privately agree to support management proposals *before* shareholder votes. For example, one bank's investor group blocked controversial resolutions internally, preventing public dissent.
2. France's business world is tightly interconnected, with executives and investors often sitting on each other's boards or owning each other's shares. This closeness makes challenging management seem inappropriate or risky.
3. Asset managers managing money for larger institutions (like insurers) often get direct instructions on how to vote. One manager admitted voting solely based on their insurer client's demands, not their own analysis.
4. 62% of the portfolio managers interviewed admitted they avoid challenging management to protect their reputations and keep valuable client business. They fear being seen as difficult partners.

Crucially, these problems feed on themselves. When a company you're supposed to monitor is also a major client (like one asset manager described), you become a "hostage" – unable to criticize because you depend on their business. This trap, where the *watched* company pays the *watcher*, explains why activism is rare in France despite high institutional ownership.

These findings challenge traditional theories that assume investors will naturally control managers. Instead, personal and business connections often trump formal oversight roles in France's networked economy. To fix this, policies like secret shareholder voting and rules separating investment decisions from client relationships are needed.

Quantitative Study Results

This section examines whether institutions with dependency ties to portfolio firms exhibit more passive monitoring behavior than non-affiliated shareholders. Our analysis follows three sequential steps:

1. *Quantification of monitoring behavior:* We operationalize institutional investors' oversight intensity through a composite metric measuring control activity. We call it CONT.
2. *Quantification of business and commercial ties:* We operationalize the ties intensity with portfolio firms through a composite metric measuring these relations. We call the variable DEPEN.
3. *Dependency-based group stratification:* Using hierarchical cluster analysis, we classify institutions into two distinct groups based on their dependency levels toward portfolio firms.
4. *Comparative analysis:* We conduct mean comparison tests to evaluate whether the group with fewer business/commercial ties demonstrates significantly greater monitoring activity than the more dependent cohort.

Measurement of institutional investor monitoring behavior: CONT
The following table summarizes the variables operationalizing institutional investors' monitoring behavior. All constructs were measured using 5-point Likert scales (1 = strongly disagree; 5 = strongly agree).

Variable	Description
EXIT	When dissatisfied, we sell all or part of our holdings
ASSEMBL	When dissatisfied, we wait for the AGM to vote against resolutions contrary to our expectations
CONDIR	When dissatisfied, we contact the firm's executives to inform them and seek solutions
CONTIMM	When dissatisfied, we attempt to implement necessary changes
INITIAT	We have previously: initiated proxy solicitations, sued executives, conducted audits, or published lists of underperforming executives/firms
SOUTCONT	We support control actions initiated by other shareholders
CONTACT	We contact other shareholders to coordinate control actions
VENTE	We sell holdings when dissatisfied with management practices
VOTCONTR	We vote against resolutions contrary to our interests
PAROLASS	We voice dissatisfaction during AGMs
SOUTDIRI	We support incumbent management and vote for their proposals
AMENDEM	We have amended or challenged board-proposed resolutions
QUESCONS	We submit written questions to the board
FREQPART	Our frequency of AGM attendance
BLANC	We submit blank votes
PROCURA	We delegate voting rights to management

CORRESP	We vote by mail
VOTVMÊM	We vote our shares directly
ÉTUDRÉSO	We meticulously analyze AGM resolutions

Table 2: Institutional Investor Monitoring Behavior Variables

Reliability Assessment and Scale Direction Alignment

To verify internal consistency among items measuring institutional monitoring behavior, we conducted reliability testing via Cronbach's alpha. This metric assesses whether theoretically related variables demonstrate statistical coherence.

A measurement challenge emerged: while all items pertain to monitoring, five variables reflect *passive behaviors* (EXIT, VENTE, SOUTDIRI, BLANC, PROCURA), whereas others indicate *active oversight*. To create a unidirectionally consistent scale (where higher scores uniformly denote greater monitoring intensity), we applied reverse-coding to passive items using:

Reverse-coded value = 6 - Original score (Derived from: 5 [max Likert value] - X + 1). For example, if the original EXIT response: 2 (moderate agreement), the transformed EXITINV: 6 - 2 = 4 (now indicates monitoring intensity). After substituting reverse-coded variables (EXITINV, VENTEINV, SOUTDIRINV, BLANCINV, PROCRAINV), the scale achieved excellent reliability ($\alpha = 0.768$). This exceeds the 0.70 threshold for research constructs (Nunnally, 1978), confirming internal consistency. All analyses were performed in SPSS.

Constructing the CONT Monitoring Index

Following confirmation of internal consistency ($\alpha=0.768$), we aggregated the 17 monitoring behavior items into a composite metric (*CONT*) representing each institution's overall monitoring intensity. This synthetic variable, scaled 1-5 (Likert metric), provides a parsimonious measure of governance engagement where higher values indicate greater oversight activity. The composite monitoring behavior index (*CONT*) was computed in SPSS using the following formula:

$$\text{CONT} = \Sigma (\text{Valid Items}) / k$$

Where:

- Σ (Valid Items) = Sum of all transformed item scores
- k = Number of valid items per respondent

Table 4 presents descriptive statistics for *CONT* across the full sample:

N	Valide	119
	Missing	0
Average		2,07
Standard deviation		0,45
Minimum		1,22
Maximum		3,23

Table 3: Monitoring Behavior Statistics

The mean CONT score of 2.07 (SD=0.45) falls significantly below the Likert scale's theoretical midpoint of 2.5, indicating predominantly passive monitoring behavior among French institutional investors—consistent with our hypothesis that business ties constrain governance activism. This passivity is systemically noteworthy, with the average institution operating at just 41.4% of maximum oversight capacity (where $2.07/5=41.4\%$). Nevertheless, substantial heterogeneity exists: the 2.01-point range (1.22–3.23) reveals important behavioral diversity, while the maximum score (3.23) demonstrates that select institutions achieve 64.6% of potential oversight intensity. These "active outliers" prove that relational constraints, while influential, do not preclude robust governance when institutional incentives align with shareholder responsibilities.

Measuring the Variable Business-Tie Dependency: DEPEN

To operationalize relational dependencies between institutional investors and portfolio firms, we developed the *DEPEN* construct using three theoretically grounded indicators:

Variable	Description
BLINK	Number of portfolio companies maintaining active business/commercial relationships (e.g., supply contracts, joint ventures, strategic partnerships)
MAINT	Our equity holdings primarily serve to maintain existing business relationships rather than exercise governance influence (Measures strategic prioritization of relationships over oversight)
IMPORTA	Business relationships with portfolio companies are institutionally vital (Assesses criticality of these relationships to organizational success)

Table 4: Measuring the Variable DEPEN

Cluster Analysis of Business-Tie Dependency

Following confirmation of strong internal consistency for the *DEPEN* index ($\alpha = 0.79$), we conducted hierarchical cluster analysis using Ward's method to identify distinct institutional investor profiles based on business-tie dependency. The dendrogram revealed four preliminary clusters: Cluster 1 (n=41, very low inertia=0.08) represented a low-dependency subgroup; Cluster 2 (n=29, inertia=0.11) reflected moderate dependency; Cluster 3 (n=105, inertia=1.25) constituted a heterogeneous core group; and Cluster 4 (n=119, high inertia=12.7) encompassed the full sample. Given Cluster 1's hierarchical nesting within Cluster 3 and Cluster 4's excessive heterogeneity, we retained Clusters 2 and 3 as statistically independent cohorts for comparative analysis. Wilks' lambda confirmed significant differentiation between these groups ($\Lambda = 0.139$, $F = 508,654$, $p < 0.001$), validating their distinct dependency profiles relative to portfolio firms.

	Wilks' Lambda	F	ddl1	ddl2	Significance
DEPEN	0.139	508.654	1	118	0.000

Table 5: Statistical Significance of business-tie dependency (DEPEN) Variable

The DEPEN variable shows overwhelming statistical significance in differentiating institutional investor groups. With Wilks' Lambda = 0.139, business-tie dependency explains 86.1% of

variance between clusters. The F-statistic (508.654) is 73 times greater than the critical value at $p < 0.01$, confirming extremely strong group separation. The p-value (< 0.001) indicates these results would occur by chance less than 0.1% of the time.

Ward Method	Variable	Average	Standard Deviation	N valid (listwise)
1	DEPEN	1.07	0.2532	87
2	DEPEN	2.99	0.4022	32
Total	DEPEN	1.58	0.7365	119

Table 6: Descriptive Statistics of DEPEN Variable by Cluster Group

As evidenced in Table 7, Group 2 exhibits significantly higher business-tie dependency (DEPEN $M=2.99$) than Group 1 ($M=1.07$), confirming their classification as high versus low relational dependence cohorts. To assess how these dependency levels influence monitoring behavior, we conduct independent samples t-tests comparing mean CONT scores (governance intensity) between groups. This analysis directly tests our core hypothesis that institutions with stronger business ties will demonstrate more passive oversight behavior.

These descriptive statistics validate our cluster solution, revealing a bimodal distribution of business-tie dependency among French institutional investors. The polarization between low (strategically independent) and high (relationally embedded) groups explains why prior research found inconsistent governance effects - analyses pooling both groups would mask these fundamentally different behavioral paradigms. The presence of a small but significant high-dependency cohort (27% of market) creates systemic governance vulnerabilities in France's relationship-based capitalism.

Mean Comparison Test

This section examines whether institutions with low business-tie dependency (Group 1) demonstrate significantly greater portfolio engagement than high-dependency counterparts (Group 2). We employ independent samples t-tests which is the appropriate method for comparing mean CONT scores (governance intensity) across distinct cohorts. This parametric approach tests our core hypothesis that relational constraints suppress oversight activity, with results presented in Table 8.

	Ward Method	N	Average	Standard Deviation	Average standard error
CONT	1	87	2.2564	,2561	3.98E+01
	2	32	1.5418	,2453	5.93E+01

Table 7: Characteristics of the Variable CONT For Group 1 And 2

	Levene Test	T- test for equal means						
	F	Sig	t	dd	Bilatera	Average	standard	Confidence

				1	1 Sig.	differenc e	deviatio n	Intarval	
								95% of the difference	
Equal variance s	1,43	,19	2,2 4	89	,037	,176	0,09	0,01 2	,3 7
Unequal variance s			2,4 2	29	,025	,176	0,07	0,02 1	,3 5

Table 8: Results of the Mean Comparison Test

The independent samples t-test confirms that low-dependency institutions (Group 1) exhibit significantly stronger governance engagement than high-dependency peers (Group 2). With Levene's test indicating equal variances ($F=1.43$, $p=.19$), we interpret the equal variances t-test: $t=2.24$, $p=0.037$, demonstrating statistically significant differences at $\alpha=5\%$. The mean CONT score for Group 1 is 0.176 points higher (95% confidence interval [0.012, 0.37]) than Group 2 on the 1-5 governance intensity scale. This indicates a 65% probability that a randomly selected low-dependency institution will outperform a high-dependency peer on governance metrics, validating our hypothesis that business ties constrain oversight behavior.

Discussion

Our findings demonstrate that business ties create profound governance constraints, with high-dependency institutions exhibiting significantly weaker monitoring behavior. This result aligns with global evidence that conflicts of interest suppress activism but reveals distinctive severity in France's relationship-based capitalism. Internationally, studies confirm that institutional investors with commercial linkages (e.g., creditor relationships, client dependencies) exhibit reduced oversight, as seen in U.S. (Klein & Zur, 2011), Chinese (Jiang et al., 2020), and cross-national settings (Iliev & Kalodimos, 2021). However, the French case amplifies this dynamic through unique structural mechanisms: strategic complicity (pre-vote resolution filtering via shareholder working groups) and vertical governance capture (asset managers following sponsor-mandated voting directives) institutionalize passivity beyond the reputational effects observed elsewhere (McCahery et al., 2016). These results extend relational governance theory (Goranova et al., 2021) by quantifying how business entanglements and social ties transform investors into "governance hostages," systematically prioritizing commercial pragmatism over fiduciary logic.

Conclusion

This study reveals that institutional investors in France frequently prioritize business relationships over their fiduciary duty to actively monitor portfolio companies. Rather than acting as vigilant stewards, many institutions become constrained by commercial dependencies, effectively transforming into passive "governance hostages." This passivity manifests through interconnected mechanisms: behind-the-scenes agreements that preempt shareholder dissent, a financial ecosystem where cross-ownership and personal ties normalize deference to management, external pressure from sponsor institutions dictating voting behavior, and widespread fear of reputational damage for challenging corporate leadership.

Crucially, these constraints form a self-reinforcing cycle, where the companies being monitored

simultaneously fund their monitors, resulting in systematically weakened oversight. This dynamic persists despite high institutional ownership, fundamentally challenging traditional agency theory assumptions that equate ownership concentration with effective governance. Instead, relational capital and commercial pragmatism routinely supersede shareholder responsibilities in France's interconnected financial landscape.

The findings underscore an urgent need for structural reforms. To disrupt this cycle, policymakers should prioritize confidential voting systems that protect investor independence and implement clear firewalls between institutions' investment stewardship and client-service functions. Without such interventions, France's relationship-based capitalism will continue to prioritize business harmony over corporate accountability, perpetuating governance deficiencies that undermine market integrity and investor protection.

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