

WHEN DOES OWNERSHIP MATTER? BOARD CHARACTERISTICS AND BEHAVIOR

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We develop a contingency approach to explain how firm ownership influences the monitoring function of the board—measured as the magnitude of external audit fees contracted by the board—by extending agency theory to incorporate the resource dependence notion that boards have distinct incentives and abilities to monitor management. Analyses of data on Continental European companies reveal that while board independence and audit services are complementary when ownership is dispersed, this is not the case when ownership is concentrated—suggesting that ownership concentration and board composition become substitutes in terms of monitoring management. Additional analysis shows that the relationship between board composition and external audit fees is also contingent upon the type of the controlling shareholder. Copyright © 2013 John Wiley & Sons, Ltd.

INTRODUCTION

Is the monitoring function of the board equally important in all firms, independent of their ownership structure? Recent research argues that one answer to this question is that, despite some universal principles, no “one best way” exists. For example, building on strategic governance and institutional analysis, a number of studies (e.g., Aguilera *et al.*, 2008; Aguilera and Desender, 2012; Filatotchev, Toms, and Wright, 2006) propose that effective corporate governance

is contingent upon the alignment of interdependent organizational and environmental characteristics. They define corporate governance as a system of interrelated practices having strategic or institutional complementarities, where governance practices will be effective only in certain combinations. Furthermore, these combined elements will yield different patterns of corporate governance (Aguilera, Desender, and Kabbach de Castro, 2011; Aguilera *et al.*, 2008; Adams and Ferreira, 2007). In this sense, Rediker and Seth (1995) and Sundaramurthy, Mahoney, and Mahoney (1997) maintain that monitoring effectiveness most likely emerges from a bundle of governance mechanisms, rather than from any single one. Thus, studies examining a single governance mechanism often overlook the broader linkages among various governance practices and neglect their complementary or substitutive impact on different firm outcomes.

Keywords: board of directors; monitoring; corporate governance; ownership structure; audit

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Due to the challenges shareholders face in supervising their agents, they rely on a variety of different governance mechanisms to monitor management, such as direct shareholder supervision, board control (Adams, Hermalin, and Weisbach, 2010), or external auditors (Watts and Zimmerman, 1990). The issue we address in this study is under what conditions boards will entrust external audit services to exercise their monitoring function, contingent on ownership characteristics. Hillman and Dalziel (2003) and Tuggle *et al.* (2010) state that the monitoring effectiveness of the board of directors depends not only on the directors' incentives to monitor top management, but also on their abilities to do so. The same logic can be applied to understand the degree of shareholders' monitoring of management, which is proportionate to the magnitude of their investment (incentives) and their monitoring abilities (Kaplan and Minton, 1994). Our paper offers support for the view that the effectiveness of corporate governance mechanisms must be considered in light of contingencies related to the ownership structure of the firm. In particular, we focus on the monitoring function of the board of directors, measured as the magnitude of external audit fees contracted by the board, and assess how ownership features influence the relationship between board composition and audit fees.

Extensive prior research has highlighted the insufficient representation of independent directors as a possible explanation for boards' failure to fulfill their monitoring role (e.g., Finkelstein and Hambrick, 1996). In fact, a main prescription of agency theory is that effective boards will be mainly composed of independent directors (Johnson, Daily, and Ellstrand, 1996) and will separate the position of CEO and chairperson, i.e., there should be no CEO duality (Mallette and Fowler, 1992). To empirically test whether board composition matters, one stream of research has explored the impact of board composition on firm performance, but the findings tend to be mixed and inconsistent (Dalton *et al.*, 1998; Finkelstein and Hambrick, 1996). Another stream of research suggests that while board monitoring has a direct effect on firms' strategic decisions, it has only an indirect effect on firm performance (Deutsch, 2005). Moreover, a company's financial performance is influenced by a multitude of endogenous and exogenous factors beyond its board composition (Kosnik, 1987). Thus, rather than examining boards' monitoring effectiveness

by looking at firms' financial performance, a more accurate evaluation can be obtained by analyzing discrete board decisions involving a potential conflict of interest between shareholders and management (e.g., Mallette and Fowler, 1992; Sundaramurthy, 1996). Request for external audit services falls in the realm of strategic board behavior, and we analyze how this behavior is contingent upon firm ownership structure.

Building on agency theory as well as the resource dependence notion that boards have distinct incentives and abilities to monitor management, we argue that there are substitution effects between board composition and ownership structure when it comes to monitoring. First, we propose that monitoring by the board of directors will be more important when ownership is diffused. This is so because dispersed shareholders, individually, not only lack the incentives and abilities to monitor management directly, but also find it challenging to coordinate their monitoring efforts (Davies, 2002; Aguilera, 2005). By contrast, controlling shareholders do not typically rely as much on the board to monitor management. These shareholders have both the incentives and abilities to hold management accountable for actions not aligned with their interests through their direct monitoring (Bohinc and Bainbridge, 2001). Second, we claim that the strength of these substitution effects also varies with the type of controlling owner (e.g., family, corporate, or bank controlled firms).

External auditors are a key instrument for enhancing the protection of investors' rights. Auditors attest that all shareholders are treated equally and that financial statements are in conformity with contractual commitments. The auditor considers the board as its client, since it is the board who reviews the overall planned audit scope and the audit fee (Carcello *et al.*, 2002). Furthermore, the OECD Principles of Corporate Governance (2004) state that 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 its shareholders. In most countries, these fiduciary duties take the form of statutory obligations, with some of them (e.g., Canada and the United States) having extensive case law and jurisprudence (Aguilera and Cuervo-Cazurra, 2009).

Our contributions are both theoretical and empirical. From a theoretical viewpoint, our study offers greater insight into the influence

of ownership structure on corporate governance mechanisms. Aguilera and Jackson (2003) discuss the significance of organization-environment interdependence on the effectiveness of corporate governance and the need to move beyond “under-contextualized” logics. In fact, one reason for the existing mixed empirical findings regarding the effectiveness of corporate governance practices may be the neglect of patterned variations in corporate governance present in different organizational environments. Our study builds on these arguments and suggests that the relationship between different corporate governance practices must also be investigated in light of contingencies related to the ownership structure of the firm. In particular, we extend agency theory by developing an integrated agency-resource dependence conceptual framework to analyze board strategic behavior regarding the monitoring of management, contingent on ownership structure. While agency theorists have not explicitly discussed the idea that boards vary in their ability to monitor, we assert that boards have heterogeneous abilities and incentives and, hence, boards vary in their monitoring behavior. Our framework emphasizes that one cannot understand the board’s monitoring incentives and abilities without considering the firm’s ownership structure because their interaction leads to different patterns of monitoring. From an empirical viewpoint, by looking at Continental European economies, we test the external validity of corporate governance studies conducted in the Anglo-American context. Furthermore, because our sample includes a wide variety of ownership characteristics, our results add to the comparative corporate governance literature by showing how ownership structure explains choices in governance practices.

THEORETICAL FRAMEWORK AND HYPOTHESES

Corporate governance represents an interrelated system in which some practices will be effective and relevant only in certain combinations, leading to different patterns of corporate governance (Aguilera *et al.*, 2008). In this vein, we adopt a contingency approach to examine how the ownership structure of the firm, as an exponent of the firm-environment fit, affects board strategic behavior towards the use of auditing (as a key component of board monitoring). Our theoretical

arguments draw on the integrated agency-resource dependence perspective and extend the traditional agency view by focusing on how ownership characteristics affect not only board members’ incentives to monitor, but also their abilities to do so. While the importance of incentives is recognized in agency theory, the importance of considering directors’ ability to monitor stems from the resource dependence literature (e.g., Hillman and Dalziel, 2003). Additionally, we establish that directors’ monitoring will also depend on the incentives and abilities of different types of shareholders to monitor management directly (rather than relying on the board). We argue that one cannot analyze the monitoring function of the board without considering the firm’s ownership structure, as their combination leads to different degrees of requested external audit services.

An extensive body of literature has developed to examine the level and nature of audit fees in organizations. Most prior research on audit fees is based on a theoretical model, which explains audit fees as a function of the number of audit hours and the price per hour (Simunic, 1980). Another stream of research, within the realm of corporate governance, studies the relationship between the quality of corporate governance and audit fees (e.g., Carcello *et al.*, 2002; Abbott *et al.*, 2003). There is, however, a missing conceptual link on the mechanisms underlying these relationships—particularly when it comes to the role of the board as the governing body commissioning the external audit. In order to build on this research and to provide a base model to assess our contingency approach, we first test whether the direct relationship between board composition and the level of audit fees holds for a different external environment (Continental Europe). Second, we analyze how the relationship between board composition and audit fees is influenced by firms’ ownership characteristics, in terms of concentration and owner type. Our proposed conceptual model is illustrated in Figure 1.

Board independence and external audit fees: contingent upon shareholder control

There are two competing arguments with respect to the relationship between board independence and audit fees. One view is that a more independent board reduces monitoring fees through its greater control of the monitoring environment, allowing it to reduce both the auditor’s

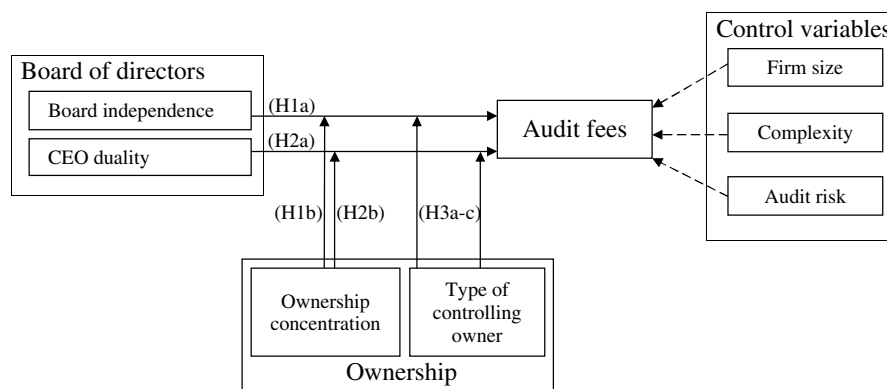


Figure 1. The relationship between board composition, ownership structure, and external audit services

assessment of control risk and the extent of audit procedures. In this scenario, there would be substitution effects between board independence and external audit fees (Abbott *et al.*, 2003; Hay, Knechel, and Wong, 2006). An alternative view is that a more independent board is concerned with effectively discharging its monitoring role, thereby increasing pressures to enhance the external audit function (Hay *et al.*, 2006) to complement their role. Independent directors have the following incentives and abilities. First, boards share with auditors the objective of identifying and rectifying reporting errors made by managers to promote shareholders' interests. Second, in order to protect their reputational capital and to avoid legal liability, independent directors have incentives to reinforce their monitoring task by requesting more audit services (Carcello *et al.*, 2002). Third, independent directors are limited by their inferior information compared to corporate executives (Jensen, 1993; Adams *et al.*, 2010), thus reducing their monitoring abilities and increasing their need to depend more heavily upon auditors. Finally, independent board members are able to enhance the scope of the audit to complement their monitoring function without bearing the cost (O'Sullivan, 2000). Empirical research has provided support for this latter complementary relationship between board independence and audit fees in the United Kingdom (O'Sullivan, 2000), the United States (Carcello *et al.*, 2002; Abbott *et al.*, 2003), and New Zealand (Hay, Knechel, and Ling, 2008).

Since the extant literature refers to the Anglo-Saxon dispersed ownership context (Hay *et al.*, 2006), examining Continental European listed firms allows for an exploration of the external validity of this line of reasoning in an environment

where firm ownership is mostly concentrated. However, we anticipate that the strength of the agency-resource dependence arguments is likely to be weaker in a Continental European context because directors' legal liability concerns are lower in a context of low litigation risk against board members. Taking these arguments together, we propose, in line with previous literature, that firms with greater board independence will seek a more comprehensive audit:

Hypothesis 1a (H1a): The relationship between board independence and external audit fees is likely to be positive.

The monitoring role of boards has been the focus of extensive corporate governance research (e.g., Adams *et al.*, 2010; Johnson *et al.*, 1996), particularly as it relates to the influence of board composition (e.g., independence and CEO duality) (Dalton *et al.*, 2007; Finkelstein and Hambrick, 1996; Johnson *et al.*, 1996). Empirical research on these agency theoretic claims regarding board monitoring is mixed. Dalton *et al.*'s (1998) meta-analysis and Dalton *et al.*'s (2007) literature review do not offer support for this relationship. Critics of the agency theory perspective have pointed out its "under-contextualized" nature and, hence, its inability to explain adequately the diversity of governance arrangements across different contexts (Aguilera and Jackson, 2003). The optimal combination of governance practices should be considered as a bundle where the effectiveness of one mechanism depends on the effectiveness of the others (Rediker and Seth, 1995).

Shareholder control is an internal governance mechanism that can range from a sole majority

owner to numerous small shareholders. We argue that there may be substitution/complementary effects between dimensions of the ownership structure (concentration/dispersion) and the board of directors in terms of monitoring management. In particular, we draw on Hillman and Dalziel (2003) as they push the agency theory logic further by bringing in a resource dependence component to propose a more comprehensive view of board activities. Although agency theorists claim that incentives will directly improve board monitoring, Hillman and Dalziel (2003) maintain that scholars must also consider board members' abilities, since both are likely to affect board behavior. Specifically, they suggest that, rather than assuming that two boards with an identical proportion of independent directors will grant equal monitoring effectiveness, it is critical to understand that these independent directors might have different incentives as well as abilities to monitor.

In this regard, we propose that the positive relationship between board independence and external audit fees (e.g., Carcello *et al.*, 2002; Abbott *et al.*, 2003; Hay *et al.*, 2006) is contingent on the ownership concentration of the firm. In particular, shareholder control is likely to affect both the incentives and the abilities of independent board members with respect to monitoring for two main reasons. First, board members are hired taking into consideration the abilities and resources they can potentially bring to the board. Dispersed shareholders entrust the board with monitoring. Therefore, we would expect that boards of firms with dispersed ownership will have a higher proportion of board members with greater monitoring skills, when compared to firms with controlling shareholders. In addition, in firms with dispersed ownership, the board is more likely to emphasize the monitoring role because greater reliance on the board is expected, as direct monitoring by shareholders becomes more costly (Aguilera, 2005). Thus, we argue that when the board's expectations towards monitoring are high, independent board members are likely to dedicate more effort to the monitoring role and seek to enhance the audit scope. In more concentrated ownership structures, large investors have the incentive to collect information and monitor management directly (Shleifer and Vishny, 1997) and, as a result, they rely less on the board for monitoring. Moreover, large investors have monitoring abilities beyond the board, as they have access

to private value-relevant information (Hefflin and Shaw, 2000), engage with management in setting corporate policy (Davies, 2002), possess some ability to influence proxy voting, and may receive special attention from management (Useem, 1996). Hence, controlling shareholders are able to monitor managerial misalignment beyond the board, which is likely to reduce the positive relationship between board independence and audit fees.

Second, the monitoring effectiveness of independent directors is limited by their inferior information compared to corporate executives (Jensen, 1993; Adams *et al.*, 2010). The information asymmetry between managers and independent directors is likely to be large in firms with dispersed ownership, inducing independent directors to complement their monitoring role through more extensive auditing. In contrast, independent board members in firms with controlling owners possess a lesser need (and fewer incentives) to rely on external auditing (Aguilera, 2005) for two reasons. First, controlling owners are likely to have the power to assure a good flow of information exchange between managers and independent directors, to assure the board can perform its monitoring role and, more importantly, to offer valuable strategic advice. Second, independent directors often maintain close ties with controlling shareholders (i.e., controlling shareholders might serve as independent directors or have representatives on the board), which grants additional sources of information. Therefore, we would expect that in firms with a large proportion of controlling shareholders on the board, there will be a lower demand for external audit services. Taking these two arguments together, we propose that the predicted positive relationship between independent boards and external audit fees will be contingent on ownership control.

Hypothesis 1b (H1b): The positive relationship between board independence and external audit fees is strengthened for firms with dispersed ownership relative to firms with concentrated ownership.

CEO duality and external audit fees: contingent upon shareholder control

CEO duality is frequently viewed as an impediment to the board's monitoring of top executives (Jensen, 1993; Aguilera, 2005) and can serve to

entrench a CEO within an organization by compromising the board's abilities to monitor and discipline management (Mallette and Fowler, 1992; Tuggle *et al.*, 2010). In addition, Jensen (1993) states that CEOs almost always set the agenda and control the information given to the board, which can hinder the ability of board members to contribute effectively to the monitoring and evaluation of the CEOs. Empirically, Tuggle *et al.* (2010) show that CEO chairs can steer boards' attention away from monitoring issues towards topics that suit their own interests, by setting and implementing more detailed, rigid agendas.

Because the audit report is an instrument to supervise managers, CEOs might have strong incentives to limit this external supervision. This is especially the case when the views of the auditors may point to inefficiencies or irregularities in managerial performance. Therefore, the presence of a dominant CEO chair is expected to be negatively related with the level of external audit (O'Sullivan, 2000). We argue that this logic also applies for CEO chairs of listed firms in a less shareholder-oriented context, in terms of reducing the boards' monitoring ability. Therefore, we propose:

Hypothesis 2a (H2a): The relationship between CEO duality and external audit fees is likely to be negative.

However, previous research has overlooked that the influence of CEO duality on the boards' demand for external audit is contingent on the firm's ownership structure, for at least two agency-resource dependence arguments. First, the more important the monitoring function of the board is, the more problematic CEO duality might become. Dispersed shareholders rely strongly on the monitoring function of the board, whereas controlling owners are more likely to be effective monitors, beyond the board. CEO duality, therefore, obstructs the board's ability to monitor (e.g., by seeking to enhance the audit scope) more strongly in firms where the board members represent dispersed shareholders, compared to firms with concentrated ownership. Therefore, the presence of controlling shareholders to overcome the dominance of dual CEOs is likely to reduce the negative relationship proposed between duality and fees.

The second argument refers to the power of CEO chairs in terms of information exchange with

the board. Adams and Ferreira (2007) maintain that CEOs face a trade-off in disclosing information to the board, and CEO duality encourages tailoring content and information to the board room. On the one hand, if a CEO reveals information, she may receive better advice. On the other hand, a board with access to better information is able to monitor the CEO more intensively. We expect CEOs to limit the transmission of information to a board representing dispersed shareholders in order to reduce the board's monitoring ability. In this scenario, an independent chairperson is likely to have incentives to enforce the board's monitoring function by enhancing the audit scope, compared to the case where the CEO is also the chairperson, leading to a negative relationship between CEO duality and audit fees. In contrast, a board less focused on monitoring due to the presence of controlling owners is expected to receive better quality of information to assist management with strategic decisions. In this scenario, we would anticipate better informed boards with fewer incentives to increase the audit scope, when the CEO is also the chairperson, compared to a scenario of no CEO duality. Taking these two arguments together, we propose the relationship between CEO duality and the demand for audit to be contingent on the ownership structure:

Hypothesis 2b (H2b): The negative relationship between CEO duality and external audit fees is strengthened for firms with dispersed ownership relative to firms with concentrated ownership.

Board composition and external audit fees: contingent upon shareholder type

Several researchers, including Mehran (1995) and Aguilera and Jackson (2003), call for a distinction between types of controlling shareholders when studying ownership structure. This is so because different types of owners pursue different strategic objectives and, thus, they can be expected to exert diverse demands from boards and disciplinary effects on managers. Given the ownership structure in Continental European firms, owners typically have been categorized into three main types: families, corporations, and banks (Barca and Becht, 2001; Shleifer and Vishny, 1997; Tribó, Berrone, and Surroca, 2007). Unlike in the United States or

Table 1. Monitoring incentives and abilities by type of controlling owner

	Family control	Corporate control	Bank control	Dispersed ownership
Monitoring incentives	High	High	Medium	Low
Monitoring abilities	High	High	High	Low
Monitoring beyond the board of directors	High	High	Medium	Low
Reliance on the board for monitoring	Low	Low	Medium	High
Relationship between board composition (independence and duality) and audit fees	Weak	Weak	Medium	Strong

the United Kingdom, institutional investors are not salient as controlling shareholders. Following this ownership type classification, we argue that different degrees of incentives and abilities to monitor management directly may exist for different types of controlling owners, compared to dispersed ownership, influencing their respective need to rely on the board. In Table 1, we present a summary of the monitoring incentives and abilities of each type of controlling owner as well as their reliance on the board of directors to monitor managers.

Family control represents a distinctive class of investors in that they hold undiversified portfolios, are long-term investors, and often occupy senior management positions—thereby placing them in a unique position to influence and monitor the firm (Shleifer and Vishny, 1997). For example, Anderson and Reeb (2003) find that families that appear in both Forbes' Wealthiest Americans Survey and the S&P 500 have over 69 percent of their wealth invested in their firms and that family members serve as CEOs in about 43 percent of the family firms in the S&P 500. In addition, Schulze *et al.* (2001) argue that family-managed firms are less likely to use formal monitoring and control mechanisms than other firms.

Family members' monitoring and disciplining of management may work effectively beyond the board not only because of their close interaction and their incentives to protect their wealth at stake, but also because family members have excellent information about the firm, as a result of a long-term relationship with the firm (Demsetz and Lehn, 1985). Since the family group tends to be the founder and, generally, has representatives within different levels of management, family owners are in a unique position to effectively monitor firm operations. In addition, they can monitor at a much lower cost than other monitors due to

their better understanding of the firm's wealth-creation processes and their greater access to internal information (Raheja, 2005). Therefore, we would expect that family ownership is likely to be a substitute for the board's monitoring role, hence weakening the relationship between board composition and audit fees:

Hypothesis 3a (H3a): The relationship between board composition (independence and CEO duality) and audit fees is weaker for family firms, compared to firms with dispersed ownership.

Firms controlled by corporations are also likely to reduce their reliance on the board for monitoring and, hence, affect the relationship between board composition and audit fees. Corporations that control other firms typically have a relatively large fraction of their holdings concentrated in a single firm or in a small number of firms. Incentives to monitor top management directly are, therefore, likely to be high. In addition, corporations often invest in firms for strategic reasons, for example, to delegate part of their activities or to take advantage of potential synergies and spillover effects between the owner and the controlled firm (Tribó *et al.*, 2007). The existence of reciprocal business relationships provides the controlling corporation with a better understanding of the business environment, as well as inside information about the firm, hence reducing the costs of direct monitoring and diminishing the need to rely on the board monitoring function. Furthermore, controlling corporations tend to have access to board members, senior managers, suppliers, and customers. Such access allows them to exert greater direct influence on corporate decisions (Barca and Becht, 2001). Given this, we would expect that direct monitoring by corporate owners may reduce the board's

focus on monitoring, weakening the relationship between the board composition and audit fees:

Hypothesis 3b (H3b): The relationship between board composition (independence and CEO duality) and audit fees is weaker for corporate controlled firms, compared to firms with dispersed ownership.

Finally, banks generally have multiple ties with the firms in which they own shares, and their equity stake primarily serves to cement an often complex set of nonshareholder relationships with a firm (Roe, 1994). There are arguments both against and in favor of banks' reliance on the board for monitoring. As an argument against, Kaplan and Minton (1994) and Kang and Shivdasani (1997) point out that banks possess private information on firms, either through the past repayment records of the bank's existing borrowers or through the banks' superior knowledge of local business conditions (Triantis and Daniels, 1995). As controlling shareholders with superior access to information and power to discipline management, it can be argued that banks are less dependent upon the board for monitoring, compared to dispersed shareholders.

There are two arguments in favor of banks relying on board monitoring. First, banks tend to have a diversified investment portfolio, which reduces the individual importance of each investment and increases their likelihood of entrusting boards with monitoring. Second, banks with both a shareholder and a creditor relationship with the firm may have a preference to complement their monitoring needs by delegating part of this task to the board, which will in turn reduce the creditor's risk of being exposed to a default, as well as protect the bank against possible lawsuits. Given these concerns, Kroszner and Strahan (2001) sustain that banks have an incentive to maintain an "arm's length" relationship with the firm. Finally, directors representing banks could face a greater reputational loss compared to other types of directors because they may be perceived as better informed and, thus, be held more responsible for the distress (Kroszner and Strahan, 2001), increasing their incentives to discharge their monitoring role through external auditing. These arguments in favor and against reliance on the board for monitoring lead us to position bank controlled firms somewhere between

firms with dispersed ownership, on the one hand, and family and corporate controlled firms, on the other hand, in terms of board monitoring:

Hypothesis 3c (H3c): The relationship between board composition (independence and CEO duality) and audit fees is weaker for bank controlled firms, compared to firms with dispersed ownership.

DATA AND METHODS

Sample

To test our proposed hypotheses, we consider nonfinancial firms listed on the Madrid Stock Exchange (Spain) and the large and mid-sized nonfinancial firms on the Paris Stock Exchange (France), for which all data was available. Financial institutions are excluded because their accounts and the auditing process are significantly different. The data is collected for fiscal year 2007. The audit fee data and corporate governance data were manually collected from companies' annual reports and corporate governance reports. The control variables related to balance sheet information and the complexity of operations come from the Thomson Reuters Worldscope database. Finally, the ownership structure data was obtained from the CMF and the CNMV (French and Spanish Securities and Exchange Commissions, respectively) databases. Both in France and Spain, it is mandatory for significant shareholders, i.e., individuals or firms who own more than five percent in a listed firm's capital, to declare their total stake in the firm, as well as any substantial changes, to the CMF or the CNMV, respectively. We use those communications from the CMF and the CNMV, and complement this data with company websites and international business media, to determine the ownership structure, considering direct and indirect ownership as well as the ownership type of the controlling shareholder.

It is important to briefly discuss the French and Spanish audit context. Compared to the United States, French legislation on auditing displays several specific and unique features. First, every listed French company that reports consolidated financial statements has to hire at least two auditors, in accordance with Article L.823-2 of the French Commercial Code. This France-specific feature,

called joint auditing, is intended to provide a twofold perspective on company accounts and, as a result, should reinforce the auditor independence. In practice, the audit report is signed by two audit partners from different audit firms, which are jointly liable for the issued opinion. Second, there is a sharp separation between the legal audit and consulting services. The Financial Security Law, introduced in 2003, has rigorously emphasized this principle of separation. As a result, the average amount of nonauditing services is less than five percent of total fees for the CAC 40 firms (AMF, 2008). Furthermore, in France, auditors are appointed for six fiscal years. Their mandate thus enjoys a legal protection, initially enforced to mitigate opinion-shopping opportunities. Following the 2002 corporate scandals, various measures have been undertaken in France, including mandatory publication of audit fees by public companies. This requires companies to distinguish, on the one hand, between fees paid for legally required audits and those paid for other services (nonaudit fees), and on the other hand, the specific fees paid to each of the two independent auditors. Since data on auditing was previously unavailable in France, very few studies have been carried out.

Spain has a relatively new statutory audit market where audits are compulsory for all medium and large companies only since the 1988 Spanish Audit Law. The Spanish audit context is similar to the French one, although somewhat less rigid. Spanish legislation permits hiring the auditor for a minimum of three years and a maximum of nine. Nonaudit services are also relatively small in Spain, although legal restrictions are less severe than in France. For an average Ibex 35 firm, less than 25 percent of the total audit firm fee stems from nonaudit activity fees. Finally, Spanish publicly listed firms typically have only one auditor. The audit market in France and Spain is dominated by the international Big 4 audit firms (KPMG, Ernst & Young, PricewaterhouseCoopers, Deloitte) plus several second-tier firms and numerous small accounting firms. The Big 4 auditors have a large geographical spread in both countries, each being present in at least 15 different cities in both France and Spain.

The litigation system remains specifically more protective in terms of legal responsibility for auditors in France and Spain, compared to the United States. Notably, it is difficult to establish an auditor's professional fault in view of his due

diligence (i.e., an obligation of means), and it is frequently impossible to prove a direct causality between this fault and the damages suffered by the plaintiffs (Piot and Janin, 2007). Further, the U.S. judicial system allows class action suits and contingent fees, which are not allowed in France or Spain. In addition, the activism of small shareholders generally requires a formal association of plaintiffs.

French and Spanish corporate governance context

As noted in the World Bank's (2008) "Doing Business" report, investor protection in both France and Spain is far below that of the United States, as well as below the average achieved by member states of the OECD. The Investor Protection Index is a subcomponent of the World Bank's (2008) Doing Business Indicators, and consists of three dimensions of investor protection: transparency of transactions, liability for self-dealing, and shareholders' ability to sue officers and directors for misconduct. The index ranges from 0 to 10, with higher values indicating greater disclosure, greater liability of directors, greater powers of shareholders to challenge the transaction, and better investor protection. While France and Spain score 5.3 and 5.0, respectively, the United States has a score of 8.3, and the OECD average is 6.0. The lower level of legal protection and the lower development of capital markets explain why these economies exhibit higher levels of ownership concentration as compared to common law countries, and even to Germany and Japan. The most common shareholders in the French and Spanish firms are families, corporations, and banks, which have a main role in the ownership structure influencing its corporate governance (Gospel and Pendleton, 2005).

Spanish corporate governance is characterized by a single board structure, which is often populated by representatives of large shareholders. French companies have historically (since 1966) been given the choice between the one-tier board model (*conseil d'administration*) and the two-tier board model with a supervisory board (*conseil de surveillance*) and a management board (*direction*). The two-tier structure is infrequent, as only 2 to 3 percent of all stock corporations and only 20 percent of the CAC 40 companies have opted for a two-tier structure. The 2001 *Loi de Nouvelle Régulation Économique* offers a third option,

which relies on the traditional one-tier board structure but breaks with the formerly mandatory concentration of powers in the hands of the CEO, who took both the position of chairman of the board and of CEO. This recent adjustment makes the French and Spanish one-tier boards very similar. We focus our analysis on firms with a single board structure to maintain a comparable sample and to be able to relate our results to prior findings from Anglo-American studies. Our sample contains 118 French-listed firms and 124 Spanish-listed firms in 2007.¹

Model specification

To test our hypotheses, we use a number of ordinary least squares regression models, extending the traditional audit fee model (Simunic, 1980; O'Sullivan, 2000; Carcello et al., 2002; Abbott et al., 2003) to include our variables of interest. It is important to highlight that for greater robustness of our estimation, we have examined the properties of the errors derived from the different model specifications. In all regressions, results for the Shapiro-Wilk and the Jarque-Bera tests indicate that error terms are normally distributed.

Regression Model I (direct effects)

Total audit fees = *f* (*Board independence*, *CEO Duality*, *Ownership concentration*, *Controls*)

Regression Model II (contingencies related to the ownership concentration)

Total audit fees = *f* (*Board independence*, *CEO Duality*, *Ownership concentration*, *Board independence* × *Ownership concentration*, *CEO Duality* × *Ownership concentration*, *Controls*)

Regression Model III (contingencies related to the type of controlling owner)

Total audit fees = *f* (*Board independence*, *CEO Duality*, *Type of controlling owner*, *Board*

¹ To deal with the impact of outliers on the results, we winsorize the observations that fall in the top 1 percent and bottom 1 percent for our key variables (i.e., audit fees and board independence), reducing our sample from 248 to 242. In addition, the Grubbs' test identifies four outliers in our final sample. Our results are, however, consistent for the exclusion of these four outlier observations.

independence × *Type of controlling owner*, *CEO Duality* × *Type of controlling owner*, *Controls*)

We first run Regression Model I for the entire sample, to test our Hypotheses 1a and 2a. Next, we employ the Regression Model II, which includes interaction terms between ownership concentration and board characteristics, to test our Hypotheses 1b and 2b. Finally, we use Regression Model III, which includes interaction terms between the type of controlling owner and board characteristics, to test Hypotheses 3a–c. The variables used in the regression models are defined as follows:

Total audit fee

Following prior studies (Hay et al., 2008; Carcello et al., 2002; Abbott et al., 2003) on the relationship between corporate governance and audit demand, our dependent variable is the natural log of audit fees. This variable considers the total fee paid for the audit services to all auditors.²

Independent variables

Board independence

We define board independence as the proportion of nonexecutive board members over the total board size³ (Carcello et al., 2002; Hay et al., 2006).

CEO duality

This variable takes the value one if the CEO and chairman positions are held by the same person and zero otherwise.

Ownership concentration

Following previous studies (La Porta et al., 1999; Faccio et al., 2001), we categorize firms as having concentrated ownership if an individual, family group, or firm has a total stake of at

² Following the suggestion of a reviewer, we have also collected audit fee data for 2008 to allow for the use of lagged independent variables (relating to 2007) and found consistent results for this alternative specification.

³ Following the suggestion of a reviewer, we acknowledge that the proportion of nonexecutive directors might not fully capture independence, which is a challenge for all research on boards. Nonetheless, the proportion of independent board members who are former employees or directors with business ties is relatively small (below 5%). A sensitivity analysis, excluding these "dubious" nonexecutive directors, shows consistent results.

least 20 percent of the shares. Both direct and indirect ownership are considered to determine the ownership structure (using a threshold level of 20 percent to define control for indirect ownership; for example, if an investor owns 80 percent of Firm X that owns 20 percent of Firm Y, then this investor controls 20 percent of Firm Y through indirect shareholdings). Firms without controlling shareholders are classified as firms with dispersed ownership. To add robustness to our analysis, we use alternative thresholds of 25 percent as well as two continuous measures (the Herfindahl index of concentration and the total shareholdings of the largest shareholder) to account for the ownership concentration.

Type of controlling owner

We have classified firms into three types of owners: families, corporations, and banks. We define the controlling owner as the largest shareholder with at least 20 percent of the shares at each step of the ownership chain—that is, taking into account both direct and indirect shareholdings, as well as possible family ties. Furthermore, in order to fully capture family ownership, we have identified the kinship relationships between individual shareholders. For example, in the case of SOS Cuétara, the largest individual shareholders (through direct and indirect shareholdings) are two brothers: Jesús Ignacio (16.0 percent) and Raúl Jaime Salazar Bello (9.7 percent). To calculate the ownership stake of the largest shareholder, we consider that the Salazar Bello family controls over 25 percent.

Control variables

Receivables and inventories

This variable is scaled by total assets and captures the complexity of the audit process (Hay *et al.*, 2006). Receivables and inventories constitute risk categories whose evaluation are complex and require more in-depth inspection, as well as relatively stronger involvement.

Size

Since the pioneering publication of Simunic (1980), as well as in other international studies (Carcello *et al.*, 2002; Abbott *et al.*, 2003), firm size appears to be the central explanatory feature

when studying audit fees. Larger companies tend to be involved in a greater number of transactions that necessarily require more work to inspect.

Foreign sales

Foreign sales, scaled by total sales, constitutes a risk category whose evaluation is complex and requires more in-depth inspection, as well as relatively stronger involvement on the part of the more experienced and expensive auditors (Hay *et al.*, 2006).

Foreign leverage

Leverage is measured as the total long-term debt divided by total assets. Firms that are highly leveraged are more likely to fail, exposing the auditor to potential litigation costs and, hence, are expected to be associated with higher fees (Simunic, 1980).

Diversity of operations

Diversity of operations is measured by the number of different sectors that the company operates, and it provides a measure of the complexity of the entity's operations (Carcello *et al.*, 2002).

Return on assets (ROA)

Client profitability is often considered a measure of risk for the auditor because it reflects the extent to which the auditor may be exposed to a loss in the event that a client is not financially viable (Simunic, 1980).

Big 4 auditor(s)

Higher audit fees are expected when an auditor is recognized to be of superior quality to other firms (Hay *et al.*, 2006). This variable takes the value one if at least one of the auditors is a Big 4 auditor and zero otherwise. It is important to note that while Spanish listed firms typically only have one auditor, French listed firms typically have two auditors.

French firm

To account for differences related to the audit context in Spain and France, we include a dummy

variable taking a value of one if the firm is listed in France and zero if the firm lists in Spain.

RESULTS

Table 2 provides an overview of the descriptive statistics for the most important variables used in our study as well as the correlations between variables. The first column shows the mean values for our sample of 242 firms, while columns 2 to 7 show the standard deviation, the minimum, and the maximum values for the firms in our sample. The average audit fee for the entire sample is \$5.9 million (median of \$3.8 million), with \$72.92 million being the highest, and \$0.02 million the lowest. The average size in terms of total firm assets is \$1,852 million. In addition, 36 percent of the firm's assets are receivables and inventory, 36 percent of its sales are made in foreign markets, and the average leverage is 49 percent. Furthermore, firms operate in 3.13 different industries segments, have an average ROA of 7 percent, and about 90 percent of all firms have at least one Big 4 auditor. These firms also show a high degree of ownership concentration, with 70 percent of the firms having a controlling owner, spread over family control (36 percent), bank control (13 percent), and corporate control (21 percent). Moreover, for the entire sample, the average shareholdings by the largest shareholder amount to almost 40 percent and the total shareholdings by significant family, corporate, and bank owners are 48 percent. In terms of board composition, 77 percent of the board members are nonexecutives, and in 56 percent of the firms in our sample, the CEO also serves as chairman.

The correlations coefficient between audit fees and the variables considered show the expected sign, except for ROA for which the coefficient is positive but close to zero. In line with previous literature, the highest correlation coefficient is found for firm size. Furthermore, ownership concentration and duality are negatively correlated with audit fees, while board independence is not significantly correlated with audit fees. We also test for possible multicollinearity considering the independent and control variables. The Variance Inflation Factor gives a mean value of 1.27 and a maximum value of 1.84 for firm size, indicating that there are no multicollinearity problems.

Table 2. Descriptive statistics and correlations

	Mean	S.D.	Min	Max	1	2	3	4	5	6	7	8	9	10
1 Audit fees (ln)	15.59	2.16	7.96	18.11	1.00									
2 Board independence	0.77	0.12	0.25	1.00	0.02	1.00								
3 CEO duality	0.56	0.50	0.00	1.00	-0.13**	0.04	1.00							
4 Concentrated ownership	0.70	0.46	0.00	0.99	-0.21***	-0.08	0.06	1.00						
5 Receivables and inventory	0.36	0.19	0.00	0.96	0.04	-0.13*	-0.05	-0.03	1.00					
6 Size	21.34	1.90	16.71	25.94	0.75***	-0.02	-0.09	-0.02	-0.08	1.00				
7 Foreign sales	0.36	0.27	0.00	0.98	0.44***	-0.04	-0.04	-0.10	0.02	0.31***	1.00			
8 Leverage	0.49	0.50	0.05	1.00	0.27***	0.02	-0.05	0.12*	0.08	0.43***	0.03	1.00		
9 Diversity of operations	3.13	1.65	1.00	8.00	0.36***	-0.02	-0.06	-0.01	0.00	0.44***	0.14**	0.25***	1.00	
10 Return on assets	0.07	0.09	-0.54	0.49	0.02	-0.13**	0.02	-0.03	0.05	0.10	-0.09	-0.08	0.03	1.00
11 Big 4 auditor(s)	0.90	0.30	0.00	1.00	0.27***	0.08	-0.17**	-0.07	-0.10	0.29***	-0.04	0.05	0.15***	0.12*

N=242

* $p > 0.10$, ** $p > 0.05$, *** $p > 0.01$ (two-tailed test).

Next, we discuss the multivariate analysis to test our hypotheses. Table 3 presents the results obtained from Regression Models I and II. Model 1 shows the base model without the board and ownership related variables. Consistent with previous literature, the control variables explain a large proportion of the audit fee variance. Receivables and inventory, firm size, foreign sales, and the presence of Big 4 auditor(s) are associated with higher audit fees. We next present models 2–5, considering the direct effect of the board characteristics, the ownership structure, and the control variables on audit fees, for different specifications of ownership concentration. The specification of model 2, which defines ownership concentration as a dummy variable taking the value one if there is a shareholder with at least 20 percent of the shares, increases the explained variance with respect to the base model, from 63.8 percent to 67.3 percent. The results from this first regression provide support for our Hypothesis 1b, showing that firms with CEO duality have lower audit fees. Board independence (H1a) shows a positive, although insignificant, relationship with audit fees. The findings in model 3 are identical to those of model 2. Models 4 and 5, with the continuous ownership variable, show a weak positive significant sign for board independence (H1a) and a negative significant sign for duality (H2a). Without considering the interaction between the ownership structure and the board composition, the results from models 2–5 are mostly in line with findings in previous studies. One could argue that the lower risk of lawsuits reduces the incentives of directors to complement their monitoring role, causing a weaker relationship between board composition and audit fees in such a setting.

To analyze how ownership characteristics influence board behavior with respect to audit fees, we present the results for Regression Model II in Table 2, models 6–9. Using interaction terms, we are able to test whether the relationship between the board characteristics and audit fees is significantly different for firms with concentrated ownership when compared to firms with dispersed ownership, testing H1b and H2b. Model 6 presents the interaction effect of ownership concentration on the relationship between board characteristics and audit fees, with ownership concentration defined as a dummy variable taking the value one if there is a shareholder controlling at least 20 percent of all shares. The model increases

the amount of variance explained from 63.8 to 70.3 percent, with respect to the base model. Furthermore, the analysis provides support for H1b and H2b, showing that the relationship between board characteristics and external audit demand is contingent on ownership concentration. The relationship between board independence and audit fees, as well as the relationship between duality and audit fees, is significantly different for firms with concentrated ownership when compared to firms with dispersed ownership.

Figure 2a illustrates the relationship between board independence and audit fees under concentrated and dispersed ownership. The slope of board independence on audit fees is steep under dispersed ownership while it is almost flat under concentrated ownership, indicating that the impact of the board independence on audit fees is greater when ownership is dispersed. Thus, ownership concentration weakens the positive effect of board independence on audit fees, as well as the negative effect of duality on audit fees (Figure 2b). To test the robustness of our results, we replicate our analysis for different specifications of ownership concentration. Model 7 defines ownership concentration as a firm where the largest shareholder owns at least a 25 percent of all shares. Furthermore, we rely on two continuous variables to measure ownership concentration. Model 8 uses the Herfindahl index, while model 9 uses the total ownership of the largest shareholder. Our main results hold for all specifications of ownership concentration. Overall, our findings support H1b and H2b by showing that ownership concentration significantly influences the negative relationship between board independence and audit fees, on the one hand, and the positive relationship between duality and audit fees, on the other hand.

Finally, we discuss the results with respect to Hypotheses 3a–c, analyzing how the type of controlling owner influences board behavior with respect to monitoring. The results for Regression Model III are presented in Table 4. We distinguish between three types of controlling owners (i.e., families, corporations, and banks) and use firms without controlling owners (dispersed) as the benchmark in our analysis. Models 10 and 11 present the interaction effect of the type of controlling owner on the relationship between board characteristics and audit fees, using two different thresholds to define ownership control, i.e., 20 and 25 percent. Our results show that the relationship

Table 3. Results of regression analysis—Model I and II

Dependent variable: audit fees	H	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8	Model 9
Ownership concentration:			SH1 > 20%	SH1 > 25%	Herfindahl	SH1	SH1 > 20%	SH1 > 25%	Herfindahl	SH1
<i>Independent variables</i>										
Board independence	H1a		0.9546 (0.6928)	1.0369 (0.6939)	1.2580* (0.7053)	1.1982* (0.6997)	4.7251*** (1.1940)	3.6860*** (1.1102)	2.6979*** (0.9450)	4.0791*** (1.2587)
CEO duality	H2a		-0.4913*** (0.1757)	-0.5238*** (0.1761)	-0.5374*** (0.1792)	-0.5354*** (0.1779)	-1.3072*** (0.2916)	-1.1246*** (0.2688)	-0.8422*** (0.2351)	-1.0718*** (0.3022)
Ownership concentration			-0.7349*** (0.1800)	-0.6579*** (0.1702)	-0.8844** (0.3442)	-1.0226*** (0.3219)	2.8350*** (1.1012)	2.1275*** (1.0630)	3.8337* (2.2680)	4.2110*** (2.1333)
Board independence	H1b						-5.4105*** (1.3926)	-4.3179*** (1.3438)	-6.7771*** (2.8217)	-7.6640*** (2.6918)
*Concentrated ownership							1.1603***	0.9904***	1.3154**	1.3472**
CEO duality*Concentrated ownership	H2b						(0.3441)	(0.3353)	(0.6562)	(0.6319)
<i>Control variables</i>										
Receivables and inventory		1.2005** (0.4255)	1.1151*** (0.4095)	1.1424*** (0.4106)	1.1436*** (0.4183)	1.1240*** (0.4153)	0.7719* (0.3964)	0.9455** (0.3995)	0.9722** (0.4172)	0.9093** (0.4123)
Size		0.7383** (0.0622)	0.7184*** (0.0594)	0.7170*** (0.0596)	0.7088*** (0.0610)	0.7034*** (0.0606)	0.7063*** (0.0572)	0.6969*** (0.0582)	0.7073*** (0.0604)	0.6939*** (0.0597)
Foreign sales		1.4254*** (0.3514)	1.2291*** (0.3364)	1.2894*** (0.3369)	1.2727*** (0.3433)	1.2605*** (0.3408)	1.2169*** (0.3206)	1.2694*** (0.3253)	1.1581*** (0.3411)	1.1574*** (0.3349)
Leverage		-0.4890 (0.5302)	-0.1580 (0.5098)	-0.2318 (0.5097)	-0.2368 (0.5220)	-0.1672 (0.5193)	-0.1460 (0.4867)	-0.2378 (0.4925)	-0.2947 (0.5159)	-0.1694 (0.5093)
Diversity of operations		0.0189 (0.0475)	0.0045 (0.0454)	0.0018 (0.0456)	0.0131 (0.0465)	0.0126 (0.0461)	0.0319 (0.0436)	0.0288 (0.0444)	0.0228 (0.0460)	0.0292 (0.0453)
Return on assets		-0.0106 (0.0102)	-0.0050 (0.0098)	-0.0040 (0.0098)	-0.0055 (0.0100)	-0.0047 (0.0099)	-0.0051 (0.0093)	-0.0055 (0.0095)	-0.0054 (0.0099)	-0.0040 (0.0098)
Big-4 auditor(s)		0.7700** (0.2978)	0.5412* (0.2879)	0.5906** (0.2884)	0.5681* (0.2939)	0.5657* (0.2917)	0.5576** (0.2748)	0.6925** (0.2795)	0.5620* (0.2930)	0.5486* (0.2881)
French firm		0.7522** (0.1844)	0.9951*** (0.1921)	1.0395*** (0.1930)	1.0221*** (0.1963)	1.0305*** (0.1949)	1.0364*** (0.1838)	1.0524*** (0.1879)	1.0925*** (0.1962)	1.1150*** (0.1937)
Constant		1.7218** (0.7105)	1.3376 (0.8758)	1.9078** (0.8918)	1.6503* (0.9033)	1.9290** (0.9080)	-0.3112 (1.2027)	0.3327 (1.1567)	0.7581 (1.0350)	0.1220 (1.2310)
Adjusted R ²		0.6386	0.6728	0.6705	0.6589	0.6639	0.7030	0.6929	0.6682	0.6781

(N = 242);
 * $p < 0.10$ ** $p < 0.05$ *** $p < 0.01$ (two-tailed test).

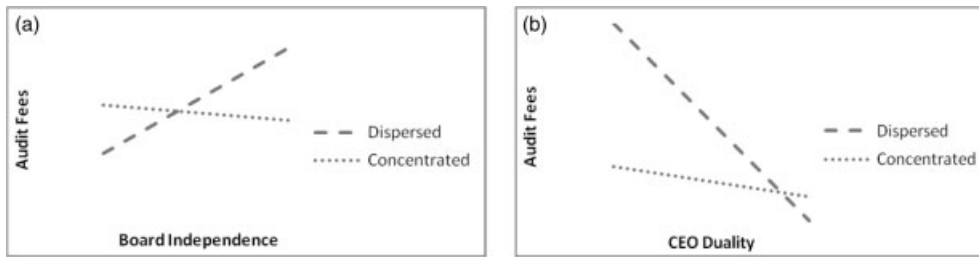


Figure 2. Moderating effect of ownership concentration (a) on the relationship between board independence and audit fees and (b) on the relationship between CEO duality and audit fees

between board independence and audit fee is significantly different for firms with family and corporate owners, compared to firms without controlling owners. While the interaction coefficient between board independence and bank control is also negative, bank controlled firms are not significantly different from firms with dispersed ownership in terms of the relationship between board independence and audit fees. The results are very similar with respect to CEO duality. We find that the relationship between duality and audit fee is significantly different for firms with family and corporate owners, compared to firms without controlling owners, providing support for H3a and H3b. The interaction coefficient for bank control is also positive and weakly significant in model 10, and positive but insignificant in model 11.

Figure 3a illustrates the relationship between board independence and audit fees considering the three different types of controlling owners and firms without controlling owners. Under dispersed ownership, the slope of board independence on audit fees is the steepest, while it is less steep for bank controlled firms and almost flat for family and corporate controlled firms, indicating that the impact of board independence on audit fees is greater when ownership is dispersed. In the case of CEO duality (Figure 3b), the relationship is the strongest for dispersed ownership, weaker for bank and family controlled firms, and the opposite (i.e., slightly positive) for firms with corporate owners. These results provide strong support for our Hypotheses 3a–c, demonstrating that the relationship between board composition (independence and CEO duality) and external audit fees is contingent upon the type of controlling shareholder. In line with our theoretical arguments, this relationship is weaker for family and corporate controlled firms than for bank controlled firms, relative to dispersed ownership.

DISCUSSION

Empirical research on how the composition of the board of directors determines its strategic behavior shows inconclusive results. In light of this, Rediker and Seth (1995) and Sundaramurthy *et al.* (1997) point out that research on a single governance practice often neglects the broader linkages to other existing governance traits in the firm and their joint impact. Building on this stream of literature, we adopt a contingency approach to explain how the ownership structure of the firm will affect the strategic behavior of the board towards the extent of auditing. The amount of audit fees contracted by the board is a valuable indicator by which to observe strategic board behavior with respect to the monitoring function, as auditing research (e.g., Carcello *et al.*, 2002) has shown that boards are more supportive of the external audit function (which leads to higher audit fees) when directors are more concerned with fulfilling their monitoring role. We extend agency theory with the resource dependence notion that boards have distinct incentives and abilities to monitor management. While the importance of incentives is recognized in agency theory, we follow Hillman and Dalziel's (2003) assessment that it is not sufficient to consider incentives of board members without considering simultaneously their abilities. We argue that ownership structure is likely to be related to the heterogeneity in board monitoring ability and, as a consequence, two boards with the same degree of board independence but different ownership structures may lead to different monitoring outcomes. Our primary theoretical arguments draw on the integrated agency-resource dependence perspective and contribute, theoretically and empirically, to this line of research by showing that board monitoring incentives and abilities are contingent on ownership structure.

Table 4. Results of regression analysis—Model III: controlling shareholder type

Dependent variable: audit fees	H	Model 10	Model 11
Control ^a		Control > 20%	Control > 25%
<i>Independent variables</i>			
Board independence		4.7958*** (1.1852)	3.6560*** (1.1040)
CEO duality		−1.3313*** (0.2892)	−1.1377*** (0.2670)
Family control ^a		3.3541** (1.2108)	2.5933** (1.1934)
Corporate control ^a		3.4619*** (1.4592)	2.6883* (1.4917)
Bank control ^a		0.4415 (1.7429)	−0.0420 (1.7477)
Board independence × family control ^a	H3a	−5.9107*** (1.5540)	−4.7731*** (1.5397)
Board independence × corporate control ^a	H3b	−6.3913*** (1.8103)	−5.1573*** (1.8429)
Board independence × bank control ^a	H3c	−2.4251 (2.3247)	−1.6555 (2.3382)
CEO duality × family control ^a	H3a	0.9092** (0.3831)	0.7909** (0.3809)
CEO duality × corporate control ^a	H3b	1.7704*** (0.4454)	1.6285*** (0.4598)
CEO duality × bank control ^a	H3c	0.9390* (0.5570)	0.7167 (0.5627)
<i>Control variables</i>			
Receivables and inventory		0.6059 (0.3997)	0.8299*** (0.4023)
Size		0.6996*** (0.0573)	0.6900*** (0.0583)
Foreign sales		1.2400*** (0.3195)	1.2828*** (0.3247)
Leverage		−0.0593 (0.4856)	−0.2063 (0.4924)
Diversity of operations		0.0332 (0.0439)	0.0292 (0.0448)
Return on assets		−0.0025 (0.0094)	−0.0043 (0.0096)
Big-4 auditor(s)		0.5259* (0.2775)	0.6506*** (0.2827)
French firm		1.0572*** (0.1839)	1.0427*** (0.1885)
Constant		−0.2587 (1.2013)	0.5150 (1.1604)
Adjusted R ²		0.6830	0.6974

(N = 242);

*p < 0.10; **p < 0.05; ***p < 0.01 (two-tailed test for variable coefficients).

^a Firms have been classified into four categories: Family Control, Bank Control, Corporate Control and Dispersed ownership. A firm falls into one of the first three categories if the largest shareholder holds at least 20% (or 25%) of the shares.

Extensive research demonstrates that the external context is likely to influence the effectiveness of different governance practices (e.g., Kronborg and Thomsen, 2009; Crossland and Hambrick, 2011). Hence, we first examine whether there exists a direct relationship between board composition and the level of audit fees, and whether the logic developed within the Anglo-American context holds for a different environment (i.e., the Continental European setting). We find partial support. Similar to prior literature, CEO duality negatively affects audit fees. However, we did not uncover a consistent positive strong relationship between board independence and audit fees. We considered two competing explanations for these findings. First, directors might have lower incentives to supplement their monitoring role with auditing, because lawsuits against directors are much less common in Continental Europe compared to the United States (Fanto, 1998). Second, we proposed and found empirical support for the logic that the board's strategic behavior is highly influenced by the firm's ownership structure because it determines directors' incentives and abilities to monitor. In particular, board monitoring will be more important when ownership is dispersed because noncontrolling shareholders lack, individually, the incentives and abilities to monitor management directly (Davies, 2002; Aguilera, 2005). By contrast, in the presence of controlling shareholders, the need to rely on the board for monitoring management is lower, as these shareholders have both the incentives and abilities to hold management accountable. Therefore, findings on the board composition-auditing relationship could be weaker compared to previous studies conducted in the Anglo-American context because of the relevance of firms with controlling owners in our sample. Specifically, we show that there is a complementary relationship between board composition (independence and duality) and audit services when ownership is dispersed, while this relationship is not found when ownership is concentrated. Hence, there is a substitution effect between the ownership structure and the composition of the board of directors when it comes to monitoring.

We also posit that different types of controlling owners have different degrees of incentives and abilities to directly monitor management, influencing the boards' monitoring function. Given the ownership structure in Continental Europe, we look at three main types of controlling owners

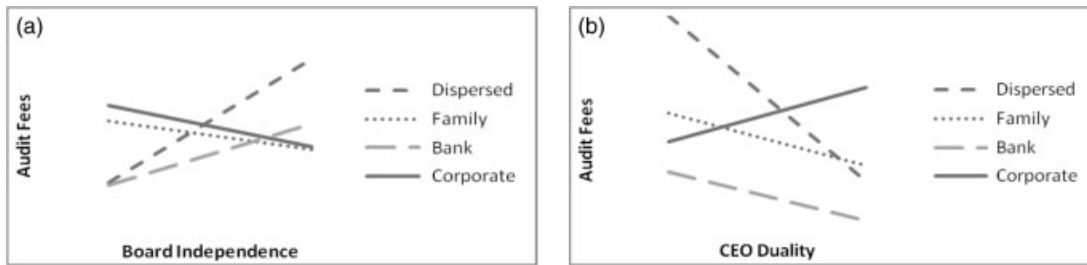


Figure 3. Moderating effect of type of controlling owners (a) on the relationship between board independence and audit fees and (b) on the relationship between CEO duality and audit fees

relative to firms with dispersed ownership: families, banks, and corporations. We argue and find empirical support for the notion that family and corporate controlling owners have higher incentives and abilities to directly monitor management, thus reducing their need to rely as much on the board for monitoring. As a consequence, the intensity of the relationship between board composition and audit fees for family and corporate controlling owners is weaker compared to that of bank controlled firms and firms with dispersed ownership.

Our research provides critical insights for the corporate governance literature in several ways. First, while Rediker and Seth (1995) suggest that important linkages should exist among different governance mechanisms, much corporate governance research is limited to homogeneous contexts, the results of which may be hard to generalize across different samples of firms or national systems. In addition, existing research focuses on single governance practices, without taking into account their potential interdependencies. We have sought to extend Rediker and Seth's (1995) concept of governance bundles by modeling and testing bundles of practices on board strategic behavior. In so doing, we reconcile prior mixed findings regarding the effectiveness of boards by showing how the ownership structure is a key contingency in understanding boards' monitoring role and, possibly, their influence on firm performance. We also expand and test the integrated agency-resource dependence perspective. We argue and provide supporting evidence that boards' incentives and abilities to monitor and, thus, their monitoring effectiveness, should be understood together with firms' ownership structures because monitoring can be achieved through different paths. Finally, our study develops and tests the organization-environment fit logic, which—while theoretically well established (e.g., Filatotchev *et al.*, 2006;

Aguilera *et al.*, 2008)—has received scant empirical examination. We can analyze the organization-environment effect by drawing on a different external environment characterized by a wide variety of ownership structures, which we can contrast with the Anglo-American structures.

Relative to previous auditing research, the context in which we test the relationship between board composition and audit fees is novel, as few studies have looked at these relationships for Continental European listed firms. More importantly, we are able to speak to the external validity of corporate governance findings conducted in the Anglo-American context and to test to what degree they are confirmed in a different external environment. Additionally, an analysis of Continental European firms allows us to explore the relationship between board composition and the external audit in the absence of strong director's legal liability, given the context of weak investor protection and a tradition of low litigation. It is, therefore, not clear that similar results would eventuate in a context of high investor protection, as shareholder legal protection could have an influence on the shareholders' incentives and abilities to directly monitor management.

For future research, it would be interesting to look at the interaction between ownership and other corporate governance practices. Ownership concentration may have a similar influence on voluntary disclosure, earnings management, compliance with corporate governance codes, and/or the adoption of risk management practices. In addition, other contingencies regarding board effectiveness could be explored. In this respect, social identity theory may help scholars to better understand board members' incentives and abilities to monitor considering the existence of multiple stakeholders. For example, Hillman, Nicholson, and Shropshire (2008) model how

directors' multiple identities affect their strategic behavior and argue that the strength of identification with a contextually relevant identity affects the extent to which directors engage in monitoring and resource provision. Future research could, therefore, look into the influence of the ownership structure on directors' identification and its influence on board monitoring.

Our research has implications for policymakers and, in particular, for the corporate governance reforms undertaken following accounting scandals on both sides of the Atlantic. Universalistic policy prescriptions in terms of board independence or CEO duality may lead to important shortcomings if they are implemented without taking into consideration the firm environment or without adapting to diverse external settings. Regulation merely focusing on board independence or CEO duality may not be sufficient since a similar degree of board independence or CEO duality does not necessarily lead to the same board monitoring effectiveness across firms. Our study highlights the influence of ownership structure on the behavior of the board of directors when it comes to requesting outside audit fees. We, therefore, argue that corporate governance recommendations and policy making could be more valuable if they accounted for potential diversity of governance mechanisms. Understanding the influence of the board of directors on monitoring management requires greater sensitivity as to how corporate governance affects different aspects of effectiveness for different stakeholders and in different contexts. We maintain that theory and empirical research should progress to a more context-dependent understanding of corporate governance and that this, in turn, will prove very useful for practitioners and policy makers designing and implementing corporate governance in particular situations.

Our study has limitations as well. First, we focus on listed companies with a single board structure. It is possible that our results may not generalize to nonlisted companies or to firms with a dual board structure such as those in Germany. Furthermore, our study draws on firms from an external context with weak investor protection. Therefore, our conclusion that the composition of the board and the ownership concentration are substitutes, in terms of monitoring, may not be generalizable to other external contexts. Given the potential influence of investor protection on shareholders' incentives and abilities to directly monitor, as well as

the presence of different types of owners, future research could especially benefit from testing our framework in different external settings. Second, while our study highlights the influence of the ownership structure on the behavior of the board of directors with respect to monitoring, we have not discussed other board functions. Future research could explore how board behavior concerning other board functions is contingent upon the context of the firms (e.g., Haynes and Hillman, 2010).

Finally, prior research has examined the relationship between audit committees on the board of directors and the characteristics of external audit, in addition to the board composition. Although audit committees were practically nonexistent prior to the early/mid-1990s in Continental Europe, they are becoming more common as a result of national and international regulatory pressures (Collier and Zaman, 2005). However, Spanish listed companies are required to have audit committees as of 2003, while they remain voluntary in France. These committees should not siphon off board power as their role is consultative.

CONCLUSIONS

Our paper offers support for the view that the effectiveness of corporate governance mechanisms must be examined in light of contingencies related to the ownership structure of the firm. In particular, we focus on the monitoring function of the board of directors, measured as the magnitude of external audit fees, and its relationship to board structure and firm ownership characteristics. To engage with previous research, we first test whether the direct relationship between board composition and the level of audit fees shown in the Anglo-American context also holds in a different shareholder environment. Second, we propose and empirically demonstrate that a firm's ownership structure shapes the incentives and abilities of board members to monitor top management. In particular, we argue that independent boards in firms with dispersed ownership are more likely to favor a higher demand for audit services in order to reinforce their monitoring function relative to boards of firms with concentrated ownership, where the board's emphasis is less on monitoring management. Our results demonstrate that, while audit services and board independence are complementary when ownership is dispersed, no

complementary relationship is found when ownership is concentrated. This is consistent with the idea that ownership concentration and the board of directors become substitutes in terms of monitoring top management. Finally, we argue and provide empirical support for the notion that the type of owner shapes the incentives and abilities of board members to monitor top management.

In sum, our study contributes to the strategic board behavior and the comparative corporate governance research by bringing a contingency perspective on how boards engage in monitoring by requesting external audit services. This behavior is likely to be influenced not only by their board composition but more importantly by the degree of ownership concentration and the type of controlling owner.

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