BOARD CHARACTERISTICS AND AUDIT FEES: WHY OWNERSHIP STRUCTURE MATTERS?

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ABSTRACT

Analysing 247 French and Spanish listed companies, we evaluate the influence of the ownership structure and the board of directors on the demand for audit. We argue that controlling shareholders influence the priorities of the board to focus on the provision of resources rather than monitoring. In contrast, boards in widely-held firms have a stronger focus on monitoring. To assess our arguments, we explore how the relationship between the board of directors and the demand for audit depends on the ownership structure. The results show that the ownership structure has a significant influence on the board's priorities and the demand for audit. For widely-held firms, we find that board independence and CEO duality are significantly related to the audit fees. In contrast, for closely-held firms, the relationship between board characteristics and the demand for external audit is insignificant.

Key Words: ownership structure, board of directors, audit demand, monitoring, resource provision
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I. INTRODUCTION

In 2007, the total audit fees paid by the French CAC40 firms were $1029 million, while the Ibex35 firm paid a total of $443 million. The main objective of statutory auditors is to protect investors' rights. More precisely, they attest that all shareholders are equally treated, and that financial statements are in conformity with contractual commitments. Thus, audit quality may improve the confidence of investors in financial reporting, facilitate the assessment of the objective situation of the firm, and finally increase fund-raising possibilities. The auditor considers the board, who reviews the overall planned audit scope and the proposed audit fee, as its client (Blue Ribbon Committee, 1999). The board of directors' duty of oversight includes a duty to ensure that "appropriate information and reporting systems" exist to provide the board with access to timely accurate and adequate information to ensure corporate compliance and business performance; however, the level of detail required is a matter of business judgment. Directors can avoid liability if they are duly diligent to make sure that standards are met. Carcello et al. (2003) argue that the board of directors may seek to protect its reputation capital, to avoid legal liability and to promote shareholder interests by purchasing differentially higher audit quality.

An extensive body of literature has developed related to the level and nature of audit fees in organizations. Recently, Hay, Knechel and Wong (2006) conducted a meta-analysis of audit research over the last 25 years and revealed that 134 out of 147 studies focus on firms from countries with an Anglo-Saxon legislation. Moreover, Hay, Knechel and Wong (2006) argue that, on the basis of their observations about anomalies, inconsistencies, and gaps in the previous literature, research could be particularly useful in examining how different forms of ownership and local institutional structures affect audit fees.

This study focuses on French and Spanish data and investigates how the ownership structure and the board of directors, affects on the demand for external audit. A comparison with previous studies using mainly U.S. data proves especially interesting given the particularities of these Continental European economies. Despite the integration of financial markets, corporate financing and governance practices remain very different in the US or UK compared to Continental European countries, like France or Spain. The role of market forces in monitoring managers' behavior is certainly weaker in France and Spain than in Anglo-American countries. Indeed, the contribution of financial markets in corporate financing is lower, and external monitoring mechanisms such as takeovers, the market for managers and nonexecutive directors, remain marginal in the corporate governance process. The French and Spanish environment is rather characterized by entrepreneurship culture and managerial power: most public companies exhibit a concentrated ownership and are controlled by a major shareholder. Controlling shareholders directly monitor managers' actions and the accounting production process, and generally dominate the board of directors. Therefore, using French and Spanish firms allows us to investigate the demand for audit by the board of directors in the context of a non-Anglo-Saxon institutional environment where firms are much more concentrated.

Zahra and Pearce (1989) and Hillman and Dalziel (2003) describe the two main functions of the Board of Directors as monitoring and providing resources (e.g., legitimacy, advice and counsel, links to other organizations, etc.). We argue that 1) the ownership structure directly influences the priorities set by the board of directors, and 2) that the demand for audit by the board of directors depends on the board's primary focus. First, the monitoring role of the board is most important when ownership is diffuse. Shareholders in firms with dispersed ownership have, collectively, a great need to use the board of directors to monitor the managers. In contrast, when ownership is concentrated, large shareholders, who are motivated to monitor management, have a lot of influence beyond the board, access to valuable information and dispose of alternative corporate governance mechanisms to disciple the managers if necessary. Second, boards with a strong focus on monitoring are more likely to have a higher demand compared to boards with a strong focus on providing resources to management.

Our results show that the ownership structure has a significant influence on the relationship between the demand for audit and board characteristics. For firms with dispersed ownership, we find that both board independence and CEO duality, i.e., the CEO also serves as Chairman of the Board, are significantly related to audit fees, similar to the findings for Anglo-American companies. In contrast, for closely held firms, the relationship between board characteristics and the demand for external audit is insignificant. These findings are in line with our argument that a firm's ownership structure has an important influence on the behaviour of the board of directors.

This paper contributes to the corporate governance literature offering greater insight into the influence of ownership on other corporate governance mechanisms. In particular, we find that the influence of the board of directors on the demand for external audit is different for firms with dispersed ownership compared to firms who have controlling owners. The results of this study also contribute to the comparative corporative governance literature by demonstration how the ownership structure may help to explain cross-country differences in governance practises. Furthermore, the results add to the broad discussion of complementarity versus substitutability of corporate governance mechanisms. The results indicate that this discussing may be different for firms with dispersed ownership compared to firms with controlling owners. Finally, this paper also has implications for policymakers and the corporate governance reforms made after the accounting scandals in the United States (Enron, Worldcom) and in Europe (Parmalat), since a similar degree of board independence may lead to different behaviour depending on the board's priorities. Therefore, corporate governance recommendations with respect to the board composition may need to consider the influence of ownership.

II. PRIOR RESEARCH AND THEORETICAL FRAMEWORK

Research on drivers of audit fees has traditionally explained the determinants of audit fees from a production-based view. The stream of literature shows that audit fees are influenced by factors related to the size of the organization, complexity, inherent risk, and litigation risk amongst others. More hours will be put into an audit to assure the accounting numbers presented reflect reality, leading to a higher audit fee when a company is large, complex and has a high the risk of accounting errors. Recently, studies focusing on the relationship between audit fees and corporate governance have introduced a new approach. Following a production-based approach, good corporate governance such as the existence of independent board members are expected to improve the control mechanisms and reduce the need for external auditing, leading to lower audit fees. However, Hay and Knechel (2004) highlight the importance of the demand effect that may lead to the opposite result: independent directors may demand more auditing in order to fulfil their responsibilities, protect their reputations and discharge their responsibility of due diligence. Specifically, Hay and Knechel (2004) argue that the demand for auditing is a function of the set of risks faced by individual stakeholders in an organization (management, shareholders, creditors, etc.) and the set of control mechanisms available for mitigating those risks. Because individual decisions concerning control processes and procedures may shift benefits and costs across groups of stakeholders, the net investment in auditing may increase (Knechel and Willekens, 2006). Empirical research has confirmed the importance of the demand-effect for audit by the board of directors.

Hay and Knechel (2004) argue that an independent board will be more concerned about discharging its monitoring role and will be more supportive of the external audit function. Clearly, independent board members may be more concerned about their personal exposure if managers misbehave and, therefore, they are more interested in an extensive audit testing in order to minimize the risk of managerial misbehaviour that could affect their personal liability. Executive board members or board members representing large shareholders are typically much better informed and are able to influence management directly. Furthermore, independent board members reduce their responsibilities, without bearing the costs (Carcello et al., 2002). This further suggests that companies with greater board independence will favor a more comprehensive audit.

H1: The demand for external audit is positively related to board independence

Another aspect of the board of directors that has been studied extensively is the CEO duality, which is generally perceived as compromising the independence of the board since one individual possesses a great amount of power and authority (Jensen, 1993). Since the audit report can be considered to be an instrument of supervision over the managers, the latter may be assumed to have powerful incentives to limit this external supervision exercised by the auditors. This is especially the case when the opinion of the auditors may indicate inefficiencies or irregularities in the managers' performance in respect to the company's resources. Therefore, managers may impose limits on the supervision by the auditors, restricting the scope of the auditors' investigations and scrutiny. In the presence of a dominant CEO, non-executives are expected to face difficulties in seeking an extensive audit, and consequently companies with CEO duality are expected to have a lower demand for external audit.

H2: The demand for external audit is negatively related to CEO duality

Consistent with the theoretical predictions, several studies have reported a positive relationship between board independence and the demand for external audit (O'Sullivan, 2000; Carcello et al., 2002; Abbott et al., 2003; Hay and Knechel, 2004). A higher degree of board independence, measured by the proportion of non-executives on the board, does not appear to substitute for audit effort; rather, such a board complements auditor oversight. Similarly, O'Sullivan (1997) finds that companies with a higher proportion of non-executive directors are more likely to purchase the monitoring of directors' and officers' insurance compared to boards with a lower proportion of non-executives. Other measures of governance linked with audit fees include the CEO duality and the existence of an audit committee. Unfortunately, research to date examining the relationship between corporate governance and audit fees is still limited, and preliminary evidence indicates conflicting results as to whether the relationship between governance and fees is positive or negative (Hay, Knechel and Wong, 2006).

Previous studies on audit fees typically use samples of large US or UK listed firms (O'Sullivan, 2000; Carcello et al. 2002, Abbott et al. 2003), which are comprised of mostly firms with dispersed ownership. Although several studies have included ownership type to explain differences in audit fees (e.g. O'Sullivan and Diacon, 2002), the empirical results about the influence of ownership control on audit fees are mixed (Hay et al., 2006). While these studies focus on a direct relationship between audit fees and measures of ownership, we are unaware of any study that investigates whether the ownership structure influences the demand for audit indirectly through the organization of the board of directors. Furthermore, the studies considering the link between board characteristics and audit fees use an agency approach, which assumes the board's main objective is to monitor the board. However, Zahra and Pearce (1989) and Hillman and Dalziel (2003) describe the two main functions of the Board of Directors as monitoring and providing resources. We argue that if the board primary focuses on the provision of resources, the relationship between the board characteristics and the audit fee will be different.

Corporate governance, ownership structure and the board's priorities

Corporate governance concerns "the structure of rights and responsibilities among the parties with a stake in the firm" (Aoki, 2001). Yet the diversity of practices around the world nearly defies a common definition (Aguilera and Jackson, 2003). In most comparisons, researchers contrast two dichotomous models, the Anglo-American and Continental European corporate governance (Becht and Roël, 1999; Hall and Soskice, 2001; La Porta et al., 1998). For example, the United Kingdom and United States are characterized by dispersed ownership where markets for corporate control, legal regulation, and contractual incentives are key governance mechanisms. In continental Europe and Japan, large shareholders such as banks and families retain greater capacity to exercise direct control and, thus, operate in a context with fewer market-oriented rules for disclosure, weaker managerial incentives, and greater supply of debt. The predominant role of corporate governance reflected in the accounting and finance literature is the agency view (Fama and Jensen, 1983; Baysinger and Hoskisson, 1990; Bathala and Rao, 1995). Agency costs arise because managers and shareholders may have different objectives: while shareholders are concerned about maximizing returns at reasonable risk, managers may prefer growth to profits (empire building may bring prestige or higher salaries), may be lazy or fraudulent ("shirk"), and may maintain costly labor or product standards above the necessary competitive minimum. To reduce the agency costs, various contractual mechanisms, including corporate boards, are designed to align the interests of the management with those of the stockholders (Shleifer and Vishny, 1997; Klein, 1998). Monitoring the actions and decisions of management is the primary focus of the board from an agency perspective.

The board of directors has emerged as both a target of blame for the recent corporate misdeeds and as the source capable of improving corporate governance. Much of the weight in solving the excess power within corporations has been assigned to the board of directors and, specifically, to non-executive directors to increase executive accountability. However, empirical studies show mixed results regarding the relationship between firm performance and board independence (e.g. Dalton, Daily, Ellstrand and Johnson, 1998; Dulewicz and Herbert, 2004; Peng, 2004; Weisbach and Hermalin, 2003). In fact, some scholars argue that a supermajority of independent directors will lead to worse performance (Bhagat and Black, 1999). Furthermore, Hillman, Cannella and Paetzold (2000) discuss how in governance research there is a need to look at skills distinct from monitoring. They posit that it is important to have board members with varied skills such as being insiders in the firm, business experts, support specialists (e.g., experts on law or public relations) and community influentials (e.g., members of a community organization). The resource dependence perspective (Pfeffer and Salancik, 1978; Boyd, 1990) presents an alternative to the agency perspective, arguing that good governance is achieved when board members are appointed for their expertise to help firms successfully cope with environmental uncertainty.

Furthermore, Aguilera (2005) and Lubatkin et al. (2005) emphasize the development a broader view of corporate governance that accounts for the different national institutions in which corporate governance is embedded. Aguilera (2005) argues that national institutions such as the ownership structure or the enforceability of corporate regulations tend to enable as well as constrain diverse corporate governance mechanisms and that a better understanding of the role of boards of directors in different institutional settings is needed to properly address how to increase board accountability. The idea presented in this paper is that the ownership structure directly influences the composition and the priorities of the board of directors as a monitoring body as opposed to a resource providing body, and indirectly influences the demand for external audit. Figure 1 graphically depicts the hypothesized relationship between ownership structure, board of directors and external audit fees. In the next section, we discuss each of the individual relationships in detail. Our paper builds on prior research linking the board composition with the demand for external audit, but focuses on Continental European companies which allows for the introduction of different ownership types.

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Ownership structure, board composition and board priorities

Agency theorists see the primary function of boards as monitoring the actions of “agents”- managers - to protect the interests of “principals” -owners (Eisenhardt, 1989; Jensen and Meckling, 1976; Mizruchi, 1983). Researchers studying the monitoring function have coalesced in their general preference for boards dominated by independent outside directors (Barnhart, Marr, and Rosenstein, 1994; Baysinger and Butler, 1985; Daily, 1995; Daily and Dalton, 1994a,b; Weisbach, 1988). They argue that boards consisting primarily of insiders (current or former managers/employees of the firm) or those outsiders who are not independent of current management or the firm (because of business dealings, family/social relationships) have less incentive to monitor management, owing to their dependence on the CEO/organization. Boards dominated by outside, nonaffiliated directors, however, are thought to be better monitors because they lack this disincentive to monitor.

Alternatively, the resource dependence perspective (Pfeffer and Salancik 1978; Boyd 1990) proposes that good governance is achieved when board members are appointed for their expertise to help firms successfully cope with environmental uncertainty. The board can have a significant effect on corporate strategy and eventually on the business risks faced by the corporation. The nature and composition of the board is potentially influenced by the need for linkages to the external environment. For example, Boyd (1990) argues that factors such as global competition, strategic business risks, and social forces will prompt firms to bring together a board that strengthens the firm's external links and helps management gain effective control over resources.

In practice, boards both monitor and provide resources (Korn/Ferry, 1999), and, theoretically, both are related to firm performance. However, the priorities of the board of directors are not independent from the context in which the company operates. Randøy and Jenssen (2004) argue that firms in highly competitive industries will already be 'monitored' by the market and, therefore, they should have fewer outside board members. In effect, they find a negative relationship between board independence and firm performance in industries with highly competitive product markets among publicly traded Swedish firms and attributed the detrimental effect on the predominance of the director's resource function over the monitoring function. Furthermore, previous literature indicates that agency problems that need to be addressed depend on the ownership structure. The monitoring role of outside directors is most important when ownership is diffuse. When ownership is concentrated, the large shareholder(s) can effectively influence and monitor the management, sometimes by personally sitting on the board. Shareholders in firms with dispersed ownership have, collectively, a great need to use the board of directors to monitor the managers, while large shareholders in firms with concentrated ownership are individually motivated to monitor management, they have a lot of influence beyond the board, access to valuable information and alternative corporate governance mechanisms to disciple the managers if necessary. Moreover, if the controlling owners are also actively involved in the management of the company, his/her need to monitor management disappears. In fact, a recent study by Fernández Méndez and Arrondo García (2007) show a negative effect of large shareholders on audit committee activity, possibly as a result of substitution between alternative control mechanisms or because of large shareholder exploitation of private benefits of control.

Therefore, a board of directors may serve the purpose of controlling shareholders much better when providing resources, by bringing in directors with expertise in the industry or political power to help maximize firm value, rather than focusing on restraining minority shareholder expropriation. On the other hand, we can expect firms without controlling shareholders to have boards acting very similar to Anglo-Saxon boards, where the monitoring role is crucial to reduce the agency problem between the dispersed shareholders and management. We expect firms with controlling owners to be more likely to have CEO duality in the board of directors. However, it is a priori not clear whether boards focusing on resource provision would have a smaller ratio of insiders/outsiders on the board, as they have a clear interest in bringing outsiders to the board as well.

Board priorities and demand for external audit

The composition and role of the board of directors, is likely to influence the demand for external audit. If the primary role of the board of directors is monitoring management, it is more likely that, similar to what studies in Anglo-Saxon countries show, the non-executive board members will push for a larger amount of external audit service. Independent board members are more likely to demand additional audit services, to improve shareholder protection and reduce their accountability. On the other hand, if the role of the board is more focused on providing resources and its composition fits this purpose, non-executive board members are less likely to persist on buying supplementary audit fees because of at least three reasons. First, non-executive board members representing controlling shareholders are much better informed and may not have incentives to discharge or seek help with external auditors. Contracting external audit services would benefit all shareholders, but the marginal benefit for board members representing controlling shareholders may not be positive. In addition, an extensive external audit will make it more difficult to expropriate minority shareholders. Second, independent board members in a board focusing on the provision of resources may be more worried about strategic actions than monitoring, and may therefore be less focused on insisting on additional audit services. Third, the proportion of truly independent board members is likely to be smaller in companies with controlling owners, giving them less power to go against management or controlling owners' interests.

H3: The demand for external audit by independent board members is significantly lower for closely held firms compared to widely held firms

In addition to the proportion of outside directors, the separation of CEO and Chairman is another important characteristic of the board of directors. Research on corporate governance suggests that less effective boards may be associated with more powerful CEOs (Daily and Dalton 1994; Kosnik 1987; Pearce and Zahra 1991). McNulty and Pettigrew (1999; Pettigrew and McNulty 1995) have further found that those boards most actively and widely involved in governance are those where power is not concentrated in the CEO, but is more widely dispersed. Maitlis (2004), on the other hand, shows that an influential CEO can be a positive force in organizational governance, and may even increase a board's effectiveness. She argues that future research needs to look more closely at the relationship between CEO activity, board behavior, and board effectiveness. Adams and Ferreira (2009) argue that the CEO faces a trade-off in disclosing information to the board. On the one hand, if he reveals his information, he gets better advice. On the other hand, a better informed board will monitor the CEO more intensively. Since an independent board is a tougher monitor, the CEO may be reluctant to share information with it. We argue that if the board of directors is designed to improve managerial decision making, the presence of the CEO on the board will be positive. Not only will its presence improve the information flow towards the board members, but the interaction and discussion of the CEO with board members may lead to more valuable advice and better firm performance (Desender, 2009). Furthermore, the problem of CEO duality may be less severe when large shareholders provide counterbalance on the board. Therefore, the relationship between the demand for audit and CEO duality may be different depending on the priorities set by the board of directors.

H4: The demand for external audit by boards with CEO duality is significantly lower for closely held firms compared to widely held firms

Ownership structure and external audit fees

According to the production-based vie, the amount of audit fees charged by the audit company will be a function of the ownership structure if the perceived risk of the task or the amount of work related to the task is higher in one ownership structure compared to another. More audit hours are required to assure the accounting numbers presented reflect reality, leading to a higher audit fee when a company is large, complex and has a high the risk of accounting errors (Hay et al. 2006). The type of ownership could increase the auditor's potential exposure to liability and lead to higher audit fees. The three most common metrics used to proxy for ownership are dummy variables for public versus private companies, stock versus mutual companies, and the existence of a major shareholder. In the latter case, the existence of a dominant shareholder could either indicate higher agency costs or stronger control, with potentially conflicting effects on audit fees. The sign of the direct relationship is a priori not clear. Depending on the likelihood of accounting inaccuracies and ease collaboration between the company and the auditor, the audit fee may be higher when a company is closely-held compared to widely-held.

H5: The demand for external audit is lower/higher for closely held firms compared to widely held firms

III. SAMPLE DESCRIPTION AND METHODOLOGY

To test our hypotheses we consider all non-financial Spanish firms listed on the Madrid stock exchange and the large and mid-sized non-financial firms on the Paris stock exchange. Financial institutions are excluded because their accounts and the auditing process are significantly different. The data is collected from different databases for fiscal year 2007. The audit fee data and the control variables relating to balance sheet information and complexity of operations come from Worldscope. The corporate governance data was manually collected from annual reports and corporate governance reports. Finally, the data on ownership structure comes from the Spanish database Sabi (Bureau Van Dijk) and the French database COFISEM.

French and Spanish audit context

Compared with the United States, French regulations on auditing display at least three specific and unique features. First, auditors in France are appointed for a six-year mandate. The auditors are not supposed to change during this six-year period; they cannot resign and cannot be dismissed during this six-year period except under exceptional circumstances. The audit mandate can be renewed without limitation for further six-year periods, except for listed companies for which a law on financial security (*Loi de Sécurité Financière*) introduced in 2003 a mandatory partner rotation every six years. Second, Moreover, management advisory services and advertising are not allowed. The average amount of non-auditing services is less than 5% for CAC-40 firms (AMF, 2008). Third, every listed French company which reports consolidated financial statements has to hire at least two auditors, in accordance with Article L.823-2 of the French commercial Code. This French specific feature, called joint-auditing, was instituted to allow a dual control. In practice, in case of joint-auditing, the audit report is signed by the two audit partners from different audit firms, which are jointly liable for the issued opinion. Liability cannot be capped by law or by contract. Legal action against a statutory auditor can be undertaken within three years after the issue of the auditor’s report, although compared with the United States, litigation rates in France are low (Piot and Janin, 2005).

The Spanish audit market possesses some peculiarities that differentiate it from other markets in other countries. Spanish legislation permits hiring the auditor for a minimum of three years and maximum of nine. In any case, when the initial contract has expired, the company can again hire the same auditor renewing his contract on a yearly basis. On the other hand, the engagement can be broken when the company wishes. The only requirement is the existence of a "just cause", but the law does not clarify what this just cause may be. A company can, therefore, hire and fire the auditor without any time limitation. Non-audit services are also relatively small in Spain, although legal restrictions are less severe than in France. For an average Ibex-35 firm, less than 20% of the total audit fee stems from non-audit fees. Finally, Spanish listed firms typically only have one auditor.

The audit market in France and Spain consists currently of the international Big 4 audit firms (KPMG, Ernst & Young, PricewaterhouseCoopers, Deloitte), plus a few large second-tier firms and numerous small accounting firms.

French and Spanish corporate governance context

The Spanish corporate governance is characterized by a single board structure, which is often dominated by the representatives of large shareholders. French companies have historically (since 1966) been given the choice between the one-tier model with the board of directors (conseil d'administration) on top and the two-tier model with the Supervisory board (conseil de surveillance) as the second board was introduced. The two-tier structure, which is closely tied to the German supervisory model, is infrequent: the two to three percent of all stock corporations that have opted for it make up twenty percent of the CAC 40 companies. Recently, the Loi Nouvelle Régulations Economique (NRE), adopted in 2001, offers a third option which relies on the traditional one-tier 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 the chief executive officer. This last 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 homogeneous sample and to be able to relate the results to prior findings from Anglo-American studies. We were able to complete the necessary data for 126 Spanish listed firms and 118 French firms. Only a few observations were lost due to missing data.

Model specification

To test our hypotheses, we estimate the following model using OLS regression (similar to the model specified in Carcello et al. 2002 and Hay, Knechel and Wong, 2006):

Regression model I (Direct effects):

Lnfee = ß0 + ß1 *Bod-i* + ß2 *Ceo-d* + ß3 *Disp* + ß4*Rec&Inv* + ß5 Lnta + ß6 *F_sales* + ß7 *n_sic* + ß8 *big4* + *e*

Regression model II (Interaction effects):

Lnfee = ß0 + ß1 *Bod-i* + + ß2 *Ceo-d* + ß3 *Disp* + ß4 *Disp*Bod-i* + ß5 *Disp*Ceo-d* + ß6 *Rec&Inv* + ß7 Lnta + ß8 *F_sales* + ß9 *n_sic* + ß10 *big4*+ *e*

The first regression is initially run for the entire sample. Afterwards, we run the first regression for firms with dispersed ownership and firms with controlling owners separately, to give an idea of how the relationship between audit demand and board composition differs. Finally, we run the second regression model, which includes interaction terms between ownership and board composition, to test our hypotheses 4 and 5. The variables used in the regression models are defined as follows:

Lnfee. Consistent with recent studies on audit fees (e.g., see Craswell et al. 1995; Carcello et al., 2002, Hay and Knechel, 2004), we use the natural log of audit fees as dependent variable. The variable considers the total fee paid to all auditors for both audit and non-audit services. The disclosure of audit fees has only recently become compulsory in Spain and France (2003).

Bod-i. We define board independence as the proportion of non-executive board members over the total board size, to compare our results to previous studies using US data (e.g. Carcello et al., 2002, Hay and Knechel, 2004). Hay and Knechel (2004) argue that independent board members will be more supportive of the external audit function because they seek to reduce their responsibility and liability and because they do not bear the cost of the audit.

Ceo-d. A second element of board composition is the CEO duality. This variable takes value 1 if the two positions are taken by the same person and value 0 if there is a separation. CEO duality is generally perceived as compromising the independence of the board since one individual possesses a great amount of power and authority (Jensen, 1993). In the presence of a dominant CEO, non-executives are expected to face difficulties in effectively monitoring management.

Disp. We categorize firms, in line with La Porta et al. (1999) and Faccio et al. (2001), as a firm with controlled ownership if a person, a family group or a firm has a total stake of at least 20% of the shares. Firms without large controlling shareholders are classified as firms with dispersed ownership. We use two alternative measures to account for the ownership structure: SH1 and SH3, measuring the total shareholdings of the largest and the three largest shareholders respectively.

Rec&Inv. Receivables and Inventories scaled by total assets captures partially the complexity of the audit process (Hay, Knechel and Wong, 2006). Receivables and inventories constitute risk categories whose evaluation is complex and requires more in-depth inspection (physical observation, etc.) as well as relatively stronger involvement on the part of the most experienced and expensive auditors. In previous studies, this variable allowed researchers to measure companies' complexity, and turned out to be useful in illustrating how audit fees are determined (Cobbin, 2002; Hay et al., 2004).

Lnta. Since the pioneering publication of Simunic (1980) on this subject as well as in other international studies (e.g., see Craswell, Francis, and Taylor 1995; Simon and Francis 1988; Carcello et al. 2002) company size appears to be the central explanatory feature when studying audit fees. This result is rather intuitive, since auditors' fees are paid according to the amount of time spent completing a given job. By and large, the bigger companies are involved in a greater number of transactions that necessarily require longer hours for an auditor to inspect.

F_Sales. Foreign sales scaled by total sales captures partially the complexity of the audit process (Hay, Knechel and Wong, 2006). Foreign constitute risk categories whose evaluation is complex and requires more in-depth inspection (physical observation, travel, etc.) as well as relatively stronger involvement on the part of the most experienced and expensive auditors.

N_sic. The number of business segments has been used (e.g., Simon 1985, Carcello et al. 2002) to provide a measure of the complexity of the entity's operations. The more business segments a company has entered, the higher the need to use most experienced and expensive auditors with industry specific knowledge.

Big4. Higher audit fees are expected when an auditor is recognized to be of superior quality to other firms (Hay, Knechel and Wong, 2006). The variable captures whether the client firms has is working with one of the 4 large auditors (i.e. KPMG, Deloitte, PwC or EY) or not. For French firms this means the variable takes value 1 if both auditors are Big4, while for Spain the variable takes value 1 if the sole auditor is a Big4. For the French sample considered, all companies have at least one Big4 auditor.

IV. RESULTS

In this section we first provide descriptive statistics and we later test the proposed hypotheses. Table 1 gives an overview of the descriptive statistics for the variables used in this study. The first column gives the values for the mean values for the entire sample, while columns 2 and 3 columns give the mean values for Spanish and French and columns 4 and 5 give the mean values for firms with controlled ownership (Disp=0) and firms with dispersed ownership (Disp=1). The total sample consists of 244 firms, 126 Spanish and 118 French firms, of which roughly 2/3 have controlled ownership and 1/3 dispersed ownership. The average audit fee for the entire sample is $10.2 million (median of €2.1 million), with an average of €13.8 million for the French firms of and €7.05 million for the Spanish firms. Part of this difference can be explained by the difference in firm size between our French and Spanish sample. The highest fee in the sample is €101.85 million while the smallest fee is €0.07 million. In addition, considering the entire sample 34% of the firm's assets are receivables and inventory, 36% of its sales are made in a foreign market and firms operate in 4.5 different industries segments. Furthermore, there is a large difference between France and Spain concerning the Big4 variable. This is however due to the difference in audit regime. All French firms have at least one big4 auditor, but only 62% of the firms are working with two Big4 auditors, i.e. 38% of the firms have one Big4 auditor and one non-Big4 auditor. Furthermore, the results show the high degree of ownership concentration. For the entire sample, the average shareholdings by the largest shareholder are almost 40% and the shareholdings by the three largest is 52%. It is remarkable how strongly the Spanish ownership structure data resembles the French. The most important differences between the firms with dispersed ownership and firms with controlling owners are found in audit fees, firm size and board composition. Firms with dispersed ownership pay higher fees are larger in size, have more independent board members and present a lower CEO duality rate.

The correlations between the variables considered in this study are presented in table 2. All correlations between the audit fee and the independent variables show the expected sign, except for the proportion of receivables and inventory. In line with previous literature, the highest correlation coefficient is found for firm size. Furthermore, the CEO duality is negatively correlated with audit fees, ownership structure is only weakly correlated and board independence is uncorrelated with the audit fees.

Next, we discuss the multivariate analysis to tests the hypotheses. Table 3 presents the results obtained from regression model 1. The first regression (R1) only takes into account the control variables. Consistent with previous literature, the control variables explain a large proportion of the audit fee variance. Firm size, foreign sales and having a Big4 auditor is associated with higher audit fees. The second (R2) regression introduces the board characteristics. Both board independence and CEO duality are significantly related to the audit fees. This is in line with previous studies and provides support for hypothesis 1 and 2. Next, the analysis is repeated for each country separately. The results for the Spanish and French firms confirm that the overall results are not driven by one particular country.

Although the results show a significant direct link between ownership and audit fees, the main purpose of this study is to investigate whether ownership influences the relationship between the board characteristics and external audit fees. The hypotheses describe how boards in firms with dispersed ownership behave differently with respect to the demand for external audit compared to firms with controlled ownership. Table 4 presents the regression results for the entire sample, and more importantly for each type of ownership separately. The relationship between characteristics the board of directors and external audit fees is different for the two types of firms. The results for the firms with dispersed ownership are in line with previous literature, i.e. a significant positive relationship between board independence and audit fees and a significant negative relationship between CEO duality and audit fees. The results for firms with controlling ownership are very different. No relationship is found between either board independence or CEO duality and the audit fees. These results are in line with the hypotheses. Furthermore, it shows that the overall positive relationship between CEO duality and audit fees is strongly driven by the subsample of firms with dispersed ownership. The results are consistent for both sub-samples

Hypotheses 4 and 5 are tested using regression model 2 and the results are presented in table 5. The results show a significant interaction term, confirming hypothesis 4 and 5.

The relationship between the board of directors and audit fees is significantly different depending on the type of ownership of the company. The analysis is repeated for both sub-samples and the results hold both in France and Spain.

V. CONCLUSIONS AND LIMITATIONS

The aim of this paper is to provide greater insight into how corporate governance mechanisms may function differently depending on the ownership structure of the company. An important novelty of this study is the introduction of the resource provision argument to explain audit fees. Following the agency perspective, we argue that a dispersed ownership structure is more likely to focus on monitoring, acting very similar to Anglo-Saxon boards, where the monitoring role is crucial to reduce the agency problem between the dispersed shareholders and management. Boards in firms with concentrated ownership tend to focus more on the provision of resources. Large controlling shareholders can effectively influence and monitor the management, sometimes by personally sitting on the board. Therefore, a board of directors may serve the purpose of controlling shareholders much better when providing resources, by bringing in directors with expertise in the industry or political power to help maximize firm value, rather than adding an additional layer of monitoring.

To assess our arguments, we examine whether the relationship between board characteristics and the demand for external audit is different for firms with dispersed ownership compared to firms with controlled ownership. We find that the ownership structure has a significant influence on the relationship between the demand for external audit and board characteristics. For firms with dispersed ownership, we find that both board independence and CEO duality are significantly related to external audit fees. This is in line with previous literature which typically considers large US or UK companies. In contrast, for closely held firms, the relationship between board characteristics and the demand for external audit is insignificant. This is consistent with a board focusing less on monitoring, but more on the provision of resources.

Furthermore, we find support for our hypotheses that the relationship between board characteristics and external audit demand is significantly different between the different types of ownership. The relationship between board independence and audit fees as well as the relationship between CEO duality and audit fees is significantly different for firms with dispersed ownership compared to firms with controlled ownership.

Our results highlight the importance of considering the ownership structure for policymakers, since a similar degree of board independence may lead to different behaviour depending on the priorities set by the board of directors. For future research, it may be interesting to look at the interaction between ownership and other corporate governance practices. Ownership control may not only influence the relationship between board independence and the demand for audit, but may have a similar influence on voluntary disclosure, compliance with corporate governance codes or the adoption of Enterprise risk management. Furthermore, it could be interesting to investigate how other stakeholders (minority investors, financial investors, lenders, employees) evaluate the difference in corporate governance approach. Finally, the results highlight that widely held companies in a different corporate environment behave similar to UK/US firms. It may therefore be interesting to investigate whether the reverse would also hold. Are closely held firms in the US/UK behaving similar to closely held firms in Continental Europe?

This study has several limitations. First, this study focuses on listed companies with a single board structure. It is therefore possible that the results may not be generalised to non-listed companies or firms with a dual board. Second, the inclusion of other countries with a corporate governance setting different from both the US and France or Spain, could further improve the analysis. A third limitation of the study is that we cannot disentangle the total audit fee into audit serves fee and non-audit fee data for the French sample, to demonstrate the robustness of the results. However, for the Spanish data this data is available to us and the results do not vary for different specifications of the dependent variable. In addition, the average non-audit fees are relatively small in France, less than 5% for CAC40 firms. Finally, the study could gain from the addition of audit committee data to the analysis. However, audit committee are a relatively recent phenomenon in both France and Spain and are probably less important in a Continental Europe corporate governance setting compared to an Anglo-American corporate governance setting. Furthermore, the audit committee is an advisory instrument of the board of directors and its composition is decided by the board of directors.

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Table 1: Descriptive statistics: differences of means

	ALL	ESP	FRA	DISP=0	DISP=1
N	244	126	118	171	73
ln_fee	14.14	13.37	14.96	13.81	14.91
Rec&inv	33.90%	36.28%	31.37%	34.66%	32.12%
ln_ta	14.42	13.96	14.91	14.39	14.48
F_Sales	35.84%	27.06%	45.23%	34.10%	28.49%
N_sic	4.50	4.13	4.90	4.47	4.56
Big4	76.63%	90.48%	61.86%	74.26%	82.19%
Disp	29.91%	29.37%	30.51%		
SH1	39.38%	39.37%	39.40%	51.43%	11.16%
SH3	51.94%	52.47%	51.36%	63.69%	24.39%
Bod-I	76.63%	79.58%	73.50%	76.00%	78.11%
Ceo-d	55.74%	42.86%	69.49%	57.89%	50.68%

Lnfee: Natural logarithm of total audit fee
Rec&inv: receivables and inventory scaled by total assets
Lnta: Natural logarithm of total assets
F_Sales: foreign sales scaled by total sales
N_sic: number of different sectors the company operates in
Big4: Dummy variable indicating if all auditors (1 in Spain, 2 in France) are Big4 or not
Disp: dummy variables, 1 if largest shareholder < 20% shares, 0 otherwise
SH1: total shareholdings by largest shareholder
Sh3: total shareholdings by three largest shareholder
Bod-i: number of non-executive board members over total board size
Ceo-d: dummy variables, 1 if CEO=chairman, 0 otherwise

Table 2: Correlation matrix

	lnfee	Rec&inv	lnta	F_Sales	n_sic	big4	Disp	Bod-i
lnfee	1.00							
Rec&inv	-0.20*	1.00						
lnta	0.73**	-0.28**	1.00					
F_Sales	0.43**	-0.10*	0.31**	1.00				
n_sic	0.39**	-0.08	0.47**	0.15**	1.00			
big4	0.24**	-0.07	0.23**	-0.07	0.07	1.00		
Disp	0.23*	-0.06	0.02	0.10	0.02	0.09	1.00	
Bod-i	-0.02	-0.13**	-0.02	-0.04	-0.01	0.11*	0.08	1.00
Ceo-d	-0.13**	0.01	-0.09	-0.01	-0.09	-0.20**	-0.07	0.04

Significance level of 0.10: *; Significance level of 0.05: **

Lnfee: Natural logarithm of total audit fee
Rec&inv: receivables and inventory scaled by total assets
Lnta: Natural logarithm of total assets
F_Sales: foreign sales scaled by total sales
N_sic: number of different sectors the company operates in
Big4: Dummy variable indicating if all auditors (1 in Spain, 2 in France) are Big4 or not
Disp: dummy variables, 1 if largest shareholder < 20% shares, 0 otherwise
Bod-i: number of non-executive board members over total board size
Ceo-d: dummy variables, 1 if CEO=chairman, 0 otherwise

Table 3: Regression results – Direct effects – full sample

	R(1)		R(2)		ESP		FRA	
	Coef.	t-stat	Coef.	t-stat	Coef.	t-stat	Coef.	t-stat
cons	2.276**	3.03	1.418	1.51	3.444**	2.54	-0.471	-0.41
country	0.938**	4.75	1.196**	5.76				
recinv	0.296	0.69	0.448	1.04	0.315	0.52	0.276	0.50
lnta	0.667**	11.68	0.659**	11.74	0.530**	5.77	0.839**	13.40
F_Sales	1.390**	4.05	1.301**	3.86	1.258**	2.10	1.489**	4.44
n_sic	0.045	0.97	0.031	0.67	-0.052	-0.67	0.110**	2.31
big4	0.935**	4.15	0.888**	4.01	0.732	1.54	0.885**	4.43
Disp	0.891**	4.83	0.833**	4.58	0.984**	3.23	0.208	1.03
bodi			1.594**	2.28	2.060*	1.83	1.718**	2.10
Ceo-d			-0.498**	-2.81	-0.722**	-2.54	-0.372*	-1.89
Number of obs	244		244		126		118	
Prob > F	0.000		0.000		0.000		0.000	
R-squared	0.6641		0.6777		0.4819		0.8252	
Adj R-squared	0.6541		0.6653		0.4465		0.8124	

Significance level of 0.10: *; Significance level of 0.05: **

Lnfee: Natural logarithm of total audit fee
Country: dummy variable, 1 if company is French, 0 if Spanish
Rec&inv: receivables and inventory scaled by total assets
Lnta: Natural logarithm of total assets
F_Sales: foreign sales scaled by total sales
N_sic: number of different sectors the company operates in
Big4: Dummy variable indicating if all auditors (1 in Spain, 2 in France) are Big4 or not
Disp: dummy variables, 1 if largest shareholder < 20% shares, 0 otherwise
Bod-i: number of non-executive board members over total board size
Ceo-d: dummy variables, 1 if CEO=chairman, 0 otherwise

Table 4: Regression results: by type of ownership

	ALL (Disp=0)		ALL (Disp=1)		ESP (Disp=0)		ESP (Disp=1)		FRA (Disp=0)		FRA (Disp=1)	
	Coef.	t-stat	Coef.	t-stat	Coef.	t-stat	Coef.	t-stat	Coef.	t-stat	Coef.	t-stat
cons	3.187**	2.90	-0.053	-0.03	4.370**	3.15	1.425	0.43	1.780	1.21	0.211	0.13
recinv	-0.270	-0.57	0.906	0.85	-0.191	-0.31	0.662	0.40	-0.446	-0.71	1.721*	1.88
lnta	0.702**	10.43	0.743**	6.77	0.608**	6.23	0.396*	1.91	0.729**	8.92	0.784**	9.24
F_Sales	1.934**	5.00	1.369**	2.06	0.556	0.89	2.250	1.50	2.019**	4.78	0.382	0.84
n_sic	0.068	1.30	0.116	1.11	-0.066	-0.85	-0.043	-0.23	0.139**	2.48	0.049	0.67
big4	0.285	1.20	0.707	1.46	0.520	1.01	0.925	0.87	0.810**	3.38	0.963**	3.40
bodi	-0.924	-1.16	3.610**	2.45	0.030	0.03	7.551**	2.62	0.291	0.28	3.816**	3.63
Ceo-d	0.218	1.09	-1.112**	-3.10	-0.321	-1.09	-1.697**	-2.53	0.093	0.37	-1.499**	-5.04
Number of obs	171		73		89		37		82		36	
Prob > F	0.000		0.000		0		0		0		0	
R-squared	0.6255		0.6970		0.5012		0.5490		0.8026		0.9255	
Adj R-squared	0.6094		0.6644		0.4580		0.4402		0.7839		0.9068	

Significance level of 0.10: *; Significance level of 0.05: **

Lnfee: Natural logarithm of total audit fee
Rec&inv: receivables and inventory scaled by total assets
Lnta: Natural logarithm of total assets
F_Sales: foreign sales scaled by total sales
N_sic: number of different sectors the company operates in
Big4: Dummy variable indicating if all auditors (1 in Spain, 2 in France) are Big4 or not
Bod-i: number of non-executive board members over total board size
Ceo-d: dummy variables, 1 if CEO=chairman, 0 otherwise

Table 5: Regression results – Interaction effects – full sample

	ALL		ESP		FRA	
	Coef.	t-stat	Coef.	t-stat	Coef.	t-stat
cons	2.388**	2.56	4.417**	3.21	0.966	0.81
country	1.234**	6.23				
recinv	0.244	0.59	0.147	0.25	0.048	0.09
lnta	0.660**	12.32	0.562**	6.26	0.773**	12.48
F_Sales	1.276**	3.98	1.056*	1.80	1.492**	4.69
n_sic	0.051	1.17	-0.063	-0.84	0.131**	2.86
big4	0.806**	3.81	0.554	1.19	0.862**	4.52
disp	-2.537**	-2.26	-4.549**	-2.16	-1.351	-1.07
bodi	0.076	0.10	0.500	0.40	0.658	0.70
Ceo-d	-0.141	-0.73	-0.452	-1.46	0.049	0.21
disp*bodi	5.175**	3.64	7.286**	2.78	3.352**	2.02
disp*Ceo-d	-1.282**	-3.82	-1.254**	-2.12	-1.305**	-3.24
Number of obs	244		126		118	
Prob > F	0.000		0.000		0.000	
R-squared	0.7114		0.5205		0.8466	
Adj R-squared	0.6977		0.4788		0.8323	

Significance level of 0.10: *; Significance level of 0.05: **

Lnfee: Natural logarithm of total audit fee
Country: dummy variable, 1 if company is French, 0 if Spanish
Rec&inv: receivables and inventory scaled by total assets
Lnta: Natural logarithm of total assets
F_Sales: foreign sales scaled by total sales
N_sic: number of different sectors the company operates in
Big4: Dummy variable indicating if all auditors (1 in Spain, 2 in France) are Big4 or not
Disp: dummy variables, 1 if largest shareholder < 20% shares, 0 otherwise
Bod-i: number of non-executive board members over total board size
Ceo-d: dummy variables, 1 if CEO=chairman, 0 otherwise

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