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Essays on Ownership Structure, Corporate Governance and Corporate Finance

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Introduction

The central theme in corporate governance was laid out by Berle and Means (1932). They noted that the separation of ownership from control produces a condition where the interests of the owner and the ultimate manager may, and often do, diverge. In the modern corporation, ownership is dispersed among numerous individuals and decision making is done by hired professional management. This allows a concentration of power in the hands of management who may advance their own interests at the cost of the owners' interests. Corporate governance addresses the relationship among the owners and the management (e.g., Monks and Minow, 1996). The central question in corporate governance is how this relationship influences strategy formulation, decision making, value creation and value distribution (Jensen et al., 1998). There are many different definitions of what corporate governance actually means:

"corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment." Shleifer and Vishny (1997).

"Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through

which the company objectives are set, and the means of attaining those objectives and monitoring performance", OECD (1999).

"Corporate governance is about promoting corporate fairness, transparency and accountability" J. Wolfensohn, president of the Word bank, as quoted by an article in *Financial Times*, June 21, 1999

"Corporate governance is the relationship among various participants (chief executive officer, management, shareholders, employees] in determining the direction and performance of corporations." Monks and Minow (1996).

Corporate governance literature addresses extensively how to protect the shareholders' interests by employing various external and internal governance mechanisms. Although corporate governance may address the interests of any stakeholder group of a company, it has traditionally studied relationships among the owners and company's top management. The main actors in corporate governance literature are typically the shareholders, board of directors, and top management (Monks and Minow, 1996). The degree of ownership dispersion varies from firms with concentrated ownership where owners are often key managers, to firms with dispersed ownership where individual owners have only a small fraction of the common stock. The modes of corporate governance vary greatly between these various kinds of organizational forms (Fama and Jensen, 1983).

The corporate governance weakness that arises from the ownership landscape prevalent in continental Europe is one of strong blockholders and weak dispersed owners. The dispersed owners are often at the mercy of blockholders that appoint the managers and devise

strategies that may benefit their own interest instead of that of the majority of shareholders. In the Anglo-Saxon countries on the other hand the ownership and control landscape can be broadly described as dispersed and highly fragmented, a direct consequence of central role of the financial markets. The dispersion produces a weakening of the ownership/control link thus allowing the board a degree of power over the direction of the company that is unparalleled in Continental Europe. When ownership is dispersed the incentives to perform direct monitoring are weak, one of the alleged weaknesses of the Anglo-Saxon system.

Recent corporate governance research suggests that a large proportion of public companies worldwide are characterized by controlling stockholders who are more often families, usually the founder(s) or their descendants. For example, Faccio and Lang (2001) report in a study of 5232 publicly traded corporations in 13 Western European countries that 36.93 % were firms with dispersed ownership, while 60.07% have large controlling owners. Thus far, most corporate governance research has focused on stylized US (and to a less extent UK) firms which separate ownership and control. Consequently, there is value in investigating firms outside the Anglo-American world when advancing research on large firms which still combine ownership and control (Carney and Gedajlovic, 2002). A recent study by De Miguel et al. (2004) find that Spanish majority shareholders manage to expropriate the wealth of minority shareholders, while in other countries – such as the UK, the US, Germany and Japan – this does not occur. They conclude that the results confirm the idea that differences in corporate governance systems lead to different value-ownership relations. The objective of this thesis is to further investigate the role of ownership structure on the effectiveness of other corporate governance mechanisms and the firm's performance.

First, we study how the role of the board of directors is influenced by the ownership structure and a how the role of the board influences its effectiveness. An important question addressed in the first chapter is whether all firms, regardless of their ownership structure, should be submitted to the 'one-rule-fits-all' recommendations of a majority of non-executive directors, the separation of the CEO and the chairman and restrictions with respect to the board size, the terms of board members and the number of board positions held in other companies. Second, we explore how the relationship between the board of directors and the demand for audit is contingent on the firm's ownership structure. Our results show that the ownership structure has a moderating effect on the relationship between the demand for audit and board characteristics. Third, we investigate the relationship between stock price performance during periods of crisis and various aspects of ownership structure. Prior research suggest that firm-level differences in ownership structure play an important role in determining changes in firm value during the financial crisis in East-Asia and Korea. In this context, we investigate the Spanish companies in order to provide new evidence in the matter. These three studies have potential implications for investors, managers and policy makers.

The first chapter develops a theoretical model to better understand how the role of the board of directors (control versus direction) is influenced by the ownership structure and a how a different role influences the board effectiveness. Most corporate governance research focuses on a universal link between corporate governance practices (e.g., board structure, shareholder activism) and performance outcomes, but neglects how the specific context of each company and diverse environments lead to variations in the effectiveness of different governance practices. This study suggests that the effectiveness of a specific corporate governance practice must also be seen in the light of contingencies related to the ownership structure of the firm. When ownership is diffuse, the control role of the board is going to be

more important because it is difficult for the dispersed shareholders to co-ordinate their monitoring activities (Davies, 2002; Aguilera, 2005). Firms with dispersed ownership may obtain higher board effectiveness if their board combines the following characteristics: a high proportion of outside board members, dual leadership, smaller board size, shorter board tenure and less directorships by its board members. The board in a firm with concentrated ownership on the other hand could be more effective when the board combines the following characteristics: a balance of insiders and outsiders, single leadership structure, larger board size, longer board tenure and more directorships by its board members. The framework suggests that corporate governance recommendations and policy making will be more effective if they take into account the potential diversity of governance mechanisms, which deal with important contingencies. Codes of corporate governance need to be sufficiently flexible to be effective. In light of scandals and perceived advantages in reforming corporate governance systems, debates have emerged over the appropriateness of implementing corporate governance recommendations mainly based on an Anglo-Saxon context characterized by dispersed ownership where markets for corporate control, legal regulation, and contractual incentives are key governance mechanisms. This paper adds to the literature that argues in favor of the need to adapt corporate governance policies to the local contexts of firms.

The objective of the second chapter is to offer greater insight into how corporate governance mechanisms are contingent on the ownership structure of the company. We argue that the ownership structure influences the behavior of the board of directors. Boards in firms with dispersed ownership, with a strong focus on control, are more likely to favor a higher demand of audit services relative to boards in firms with ownership concentration, where independent board members contribute with the provision of resources to the management. To

assess our arguments, we examine the relationship between board characteristics and the demand for external audit in firm with dispersed and concentrated ownership. The results show that the influence of board independence and single leadership on the external audit demand is contingent on the concentration of ownership. For firms with dispersed ownership, we find that both board independence and single leadership are significantly related to the total audit fees. This is in line with previous literature which typically considers large US or UK companies. In contrast, for firms with concentrated ownership, the relationship between board characteristics and the demand for external audit is insignificant. These results are consistent with the argument that the ownership structure has an important influence on the board behavior. Finally, the study shows that even in countries without a high risk of lawsuits against board members, outside board members demand for more audit, indicating that the higher demand for audit by outside board members is not only driven by the fear of facing a lawsuit. The results from this study complement the existing research conducted in the context of dispersed firms and highlight the importance of considering ownership structure patterns for policymakers, since a similar degree of board independence may lead to a different behavior contingent on the ownership structure of the firm. For future research, it may be interesting to look at the interaction between ownership and other corporate governance practices. Ownership control may have a similar influence on voluntary disclosure, compliance with corporate governance codes or the adoption of risk management practices. Finally, our findings suggest that firms with dispersed ownership in a different corporate environment behave similar to UK/US firms. It may, therefore, be interesting to explore in the future whether the reverse would also hold. Do firms with concentrated ownership in the US/UK behave similarly to firms with concentrated ownership in Continental Europe?

The third chapter studies the relationship between the ownership structure and stock price performance. Shareholder structures are quite diverse across countries, with dispersed ownership being much more frequent in US and UK listed firms, compared to Continental Europe, where controlled ownership is prevalent. The differences in ownership structure have two obvious consequences for corporate governance: on the one hand, dominant shareholders have both the incentive and the power to discipline management; on the other hand, concentrated ownership can create conditions for a new problem because the interests of controlling and minority shareholders are not aligned. Since ownership control can have both positive and negative properties, empirical evidence is of paramount importance for judging about its final effect and for orienting regulations that could hamper the persistence of large controlling shareholders. The objective of this chapter is to investigate the valuation of the ownership structure by investors during plummeting and soaring financial markets in a Continental-European setting. To obtain greater insight into the valuation of the ownership structure from a minority shareholders perspective, it is crucial to have a sample with sufficient diversity in terms of the ownership structure, a condition fulfilled in most continental Europe stock markets. Continental European firms adopt a wide variety of ownership structures, going from firms with only small diffuse shareholders to firms with majority shareholders. In addition, a European context also allows studying the importance of secondary blockholders as well as the importance of different types of the controlling owner on stock price performance. Our results show the importance of ownership concentration, the presence of secondary blockholders and the type of the controlling owner to explain stock price performance. In addition, the analysis shows that the results for extreme down markets are fundamentally different from the results for the up market. While ownership concentration is valued positively during down market periods, it is valued negatively during up market periods. This study builds on prior research in several ways. First, unlike most existing

research, which usually studies just one aspect of ownership structure, we focus on several dimensions of the ownership structure: ownership concentration, multiple blockholders and type of the controlling owner. Second, rather than focusing on periods of market crisis, we analyze the stock price performance during extreme down market periods as well as extreme up market periods. Combining both perspectives provides insight into how minority shareholders valuation changes during periods of extreme market turmoil. Our results seem to indicate that ownership concentration is associated with more stable stock valuation during periods of market turmoil; especially firms controlled by a financial institution tend to lose less value during down markets and gain less value during up markets. Third, this is one of the first papers to investigate the importance of ownership structure from a minority investor's perspective using data from a Continental European stock market. In contrast to most previous studies, our data set allows to calculate the ownership structure prior to the periods of interest and to control for stock price movements caused by movements by large blockholders during the period of market turmoil. The results also add to the convergence argument of corporate governance systems that cross-national patterns of corporate governance are converging or will converge on the Anglo-Saxon, capital-market driven model characterized by a sharp separation between ownership and control as this model more efficient than alternative models such as those underpinning family firms, conglomerates, bank-led groups or worker cooperatives. The findings of this study indicate that the minority shareholders attach a positive value to ownership concentration, especially if the controlling owner is a financial institution, in periods of extreme down markets. Furthermore, the results seem to indicate that during periods of extreme market turmoil, firms with dispersed ownership are significantly more sensitive to the stock market environment than firms with large controlling shareholders. The results of the study also have implications for policy makers, by showing that firms with concentrated ownership are less subjective to extreme

market periods. To the extent that ownership concentration might contribute to the financial and economic stability of listed firms during periods of market turmoil, this study provides empirical insights against regulations that could hamper the persistence of large controlling shareholders.

Chapter 1

The relationship between the ownership structure and board effectiveness

1.1 Introduction

The ownership structure is quite diverse across countries, with dispersed ownership being much more frequent in the US and UK, compared to Continental Europe, where concentrated ownership is prevalent among listed firms (La Porta, López-de-Silanes, Shleifer and Vishny, 1999). Faccio and Lang (2002) report in a study of 5232 publicly traded corporations in 13 Western European countries that only 36.93 percent could be considered widely held firms. The differences in ownership structure have two obvious consequences for corporate governance, as surveyed in Morck, Wolfenzon, and Yeung (2005). On the one hand, dominant shareholders have both the incentive and the power to discipline management. On the other hand, concentrated ownership can create conditions for a new problem, because the interests of controlling and minority shareholders are not aligned and the controlling shareholders could expropriate minority shareholders. Despite the important differences in the ownership structure across countries, and its effect on corporate governance, codes across the world tend to provide similar recommendations (Aguilera and Cuervo-Cazurra, 2004).

Filatotchev (2008) argues that one reason for the mixed empirical results related to the effectiveness of various governance mechanisms may be the neglect of patterned variations in corporate governance according to the contexts of different organizational environments.

Likewise, recent critiques of agency theory have centered on it being too 'under-contextualized' to compare and explain the diversity of corporate governance arrangements across different organizational or national contexts (Aguilera et al. 2008). These rather universalistic policy prescriptions lead to important shortcomings and, as a result, they need to be substantially adapted to the local contexts of firms or translated across diverse national institutional settings (Fiss and Zajac, 2004; Aguilera and Cuervo-Cazurra, 2004).

The board is by definition the internal governing mechanism that stands between two other axes in the corporate governance triangle: managers and shareholders. Fama (1980) argues that the composition of the board of directors is an important mechanism because the presence of non-executive directors represents a means of monitoring the actions of the executive directors and of ensuring that these are pursuing policies consistent with shareholders' interests. The resource dependence perspective (Pfeffer and Salancik, 1978; Boyd, 1990) presents an alternative to the agency theory, arguing that good governance is achieved when board members are appointed for their expertise to help firms successfully cope with environmental uncertainty. Bhagat and Black (1999) argue that a supermajority of outside directors will lead to worse performance. Furthermore, Hillman, Cannella and Paetzold (2000) discuss how in governance research there is a need to look at skills distinct from monitoring. They state 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). Zahra and Pearce (1989) argue that the two main roles of the board are control and direction. While the agency perspective focuses more on the control role (monitoring of the management, reporting to the shareholders, and ensuring compliance with the law), the resource provision

perspective provides support for the direction role (the strategic guidance of the company) of the board.

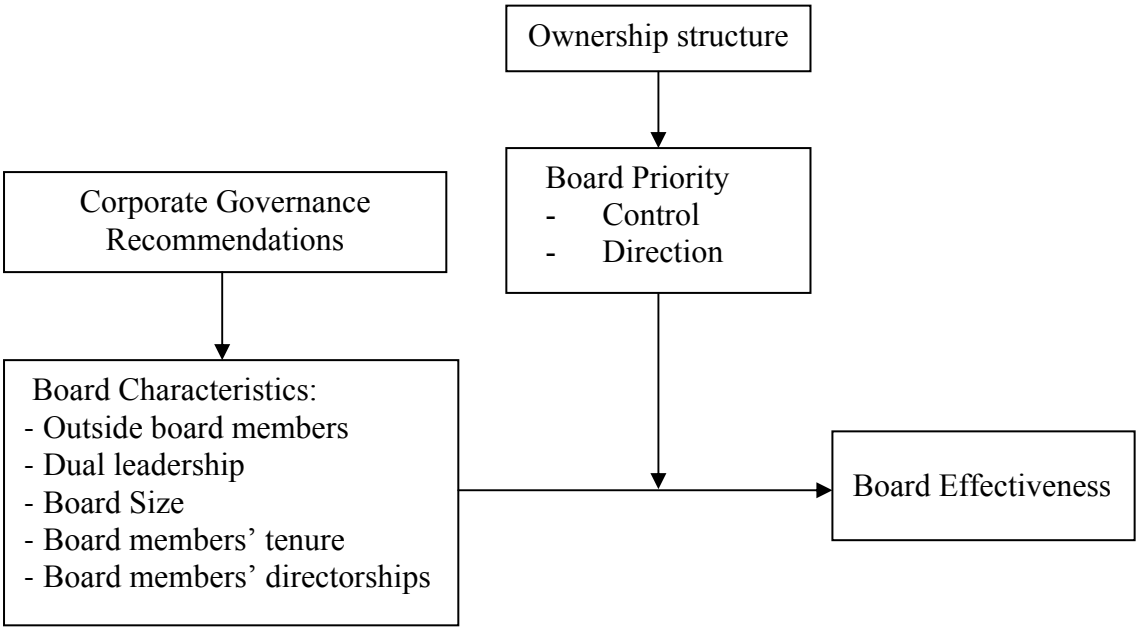

Figure 1.1: Relationship between ownership structure, board composition and board effectiveness

The paper develops a theoretical model to better understand how the role (control versus direction) of the board of directors is influenced by the ownership structure and a how a different role influences the board effectiveness. Most corporate governance research focuses on a universal link between corporate governance practices (e.g., board structure, shareholder activism) and performance outcomes, but neglects how the specific context of each company and diverse environments lead to variations in the effectiveness of different governance practices. Furthermore, an important question addressed in this paper is whether all firms, regardless of their ownership structure, should be submitted to the 'one-rule-fits-all' recommendations of a majority of non-executive directors, the separation of CEO and the chairman and restrictions related to the board size, the terms of board members and the number of board positions held in other companies. In an effort to increase the relevance of future research on boards and board effectiveness, we provide a framework (figure 1.1) that

illustrates the relationship between ownership structure, role of the board, board characteristics and board effectiveness.

This study suggests that the effectiveness of a specific corporate governance practice must also be seen in the light of contingencies related to the ownership structure of the firm. An important implication is that effectiveness does not result from a universal 'one best way', but suggests that particular practices will be effective only in certain combinations and furthermore may give different patterns of comparative institutional advantages given the contingencies of different environments. We claim that firms with dispersed ownership may obtain higher board effectiveness if their board combines the following characteristics: a high proportion of outside board members, dual leadership, smaller board size, shorter board tenure and less directorships by its board members. The board in a firm with concentrated ownership on the other hand could be more effective when the board combines the following characteristics: a balance of insiders and outsiders, single leadership structure, larger board size, longer board tenure and more directorships by its board members. In the next part of this study, we explain how the ownership structure influences the role of the board of directors. The third part looks at the moderation effect of the ownership structure on the relationship between board features and board effectiveness. We consider the board characteristics for which a clear recommendation exist in the recent codes of corporate governance in the UK, Spain and Italy. These countries are selected to contrast the recommendations made in an Anglo-Saxon context with the recommendations made in a Continental-European context. The last two sections provide the discussion and the conclusions of the study.

1.2 Ownership structure and the role of the board

One stream of the corporate governance literature (e.g. Zahra and Pearce, 1989; Forbes and Milliken, 1999; OECD, 2003; Hillman and Dalziel, 2003; Nicholson and Kiel, 2004; Aguilera, 2005) argue that the board of directors has two main roles, control (monitoring of the management, reporting to the shareholders, and ensuring compliance with the law) and direction (the strategic guidance of the company). The control role of the board is rooted in the agency theory where the primary concern of the board is to curb the self-serving behavior of agents (the top management team) that may work against the best interests of the owners (shareholders) (Jensen and Meckling, 1976; Eisenhardt, 1989). According to Fama (1980: 294), the board is the "ultimate internal monitor . . . whose most important role is to scrutinize the highest decision makers within the firm". Agency theory strongly favors outside directors, that is, those detached from management and daily operations, as they facilitate objectivity (Kosnik, 1987), while separating the CEO and the chair positions provide further checks and balances (Rechner and Dalton, 1991).

The direction role is rooted in the resource dependence (Pfeffer, 1972; Pfeffer and Salancik, 1978; Boyd, 1990; Daily and Dalton, 1994a,b; Gales and Kesner, 1994; Hillman et al., 2000; Adams, 2005) and stakeholder traditions (Johnson and Greening, 1999; Luoma and Goodstein, 1999; Hillman, Keim and Luce, 2001) and suggests that boards should take a role that focuses on advising management and enhancing strategy formulation. The resource dependence theory (Pfeffer and Salancik 1978) argues that corporate boards are a mechanism for managing external dependencies (Pfeffer and Salancik, 1987), reducing environmental uncertainty (Pfeffer, 1972) and reducing the transaction costs associated with environmental interdependency (Williamson, 1984) and ultimately aid in the survival of the firm (Singh, House and Tucker, 1986). Furthermore, insiders on the board are viewed as important

contributors as they are knowledgeable about firm operations. Empirical studies in the resource dependence tradition have shown a positive relationship between board capital and board effectiveness (e.g., Pfeffer, 1972; Boyd, 1990; Dalton et al., 1999). Carpenter and Westphal (2001) found that boards consisting of directors with ties to strategically related organizations, for example, were able to provide better advice and counsel, which is positively related to firm performance (Westphal, 1999). In addition, Hillman, Zardkoohi and Bierman (1999) found that when directors established connections to the U.S. government, shareholder value was positively affected. They conclude that such connections held the promise for information flow, more open communication and/or potential influence with the government, a critical source of uncertainty for many firms.

Boards are faced with an apparent paradox in that, on the one hand, they are expected to exercise control over the top management so that interests of shareholders (and other stakeholders) are protected; and, on the other hand, they need to work closely with the top management to provide valuable support in choosing corporate strategy and make informed decisions in implementing strategy (Hillman and Dalziel, 2003; Sundaramurthy and Lewis, 2003). The primary role of the board of directors is not independent from the context in which the company operates. The importance of the control role is expected to be influenced by the distribution of power amongst the stakeholders and their individual incentives. When ownership is diffuse, the control role of the board is going to be more important because it is difficult for the dispersed shareholders to co-ordinate their monitoring activities (and it is not worthwhile for any individual institution to monitor the company on a continuing basis) (Davies, 2002; Aguilera, 2005). Shareholders in firms with dispersed ownership prefer strategies of exit rather than voice to monitor management (Eisenhardt, 1989). To resolve the alignment problem in firms with dispersed ownership, the board primarily focuses on the

control role. While small shareholders do not have incentives to monitor individually, all shareholders, collectively, benefit from the monitoring efforts by the board of directors.

Shleifer and Vishny (1986) argue that large shareholders have strong incentives to monitor managers because of their significant economic stakes. Even when they cannot control the management themselves, large shareholders can facilitate third-party takeovers by splitting the large gains on their own shares with the bidder. Large shareholders might have access to private value-relevant information (Heflin and Shaw, 2000), engage with management in setting corporate policy (Bhagat, Black and Blair, 2004; Davies, 2002; Denis and McConnell, 2003), have some ability to influence proxy voting and, finally, may also receive special attention from management (Useem, 1996). Since blockholders have both the incentive and the power to hold management accountable for actions that do not promote shareholder value (Bohinc and Bainbridge, 2001), the control role of the board, in such a situation, is considered to be less important (La Porta et al., 1998; Aguilera, 2005). Given that the ownership structure is strongly related to the institutional context, one could expect that boards of Anglo-Saxon firms tend to focus stronger on control, while this might be less the case for boards in Continental Europe or Japan.

Adams (2005) find for a sample of Fortune 500 firms that, on average, boards devote effort primarily to monitoring, rather than dealing with strategic issues or considering the interests of stakeholders. In addition, Heidrick and Struggles (2007) surveyed 768 directors at approximately 660 of the 2,000 largest publicly traded companies in the US about a number of board issues. An important result related to this study is the appreciation of the effectiveness of US boards with respect to control and direction roles. While 95 percent of the board members qualify the control role (i.e., monitoring of the firm's financial performance)

of their board as either effective or very effective, only 59 percent believe the board to be effective with respect to shaping long-term strategy, and only 61 percent consider the board to be effective with respect to identifying possible threats or opportunities critical to the future of the company. These results are in line with the findings of the Korn-Ferry (1999) survey. In addition, the Heidrick and Struggles (2007) survey reveals that 84 percent of the board members believe that, as a result of the recent changes in corporate governance, boards are spending more time on control and less on direction.

1.3 Board characteristics and board effectiveness

An important question addressed in this paper is whether all firms, regardless of their ownership structure, should be submitted to 'one-rule-fits-all' corporate governance recommendations. We study the board recommendations made by the most recent code of corporate governance in the U.K., Spain and Italy to evaluate how these recommendations are tailored to the corporate governance context of the country. We consider the recommendations dealing with the proportion of non-executive directors, the separation of CEO and chairman and restrictions in terms of board size, in terms of the time on the board and in terms of the number of board positions held in other companies. In what follows, we argue for each recommendation how the ownership structure could affect the relationship between the board characteristics and the board effectiveness. In addition, we also link the recommendations with aggregate descriptive statistics on these corporate governance practices in different European countries characterized by single board structures.

1.3.1 The composition of the board of directors

Much of the corporate governance literature deals with the impact of board composition on board effectiveness or firm performance. Board composition within this literature is usually considered narrowly, that is, in terms of the ratio of inside (executive)

directors to outside (non-executive) directors. From an agency theory perspective, the primary concern has been the board's control role and, accordingly, whether the board composition provides sufficient directors' independence from management to protect the interests of shareholders (Johnson et al., 1996; Langevoort, 2001; Hermalin and Weisbach, 2003; Sundaramurthy and Lewis, 2003). In particular, agency theory argues that an impartial assessment of managers will occur more readily if the board is independent of executive management. Since the insider directors are subordinates of the CEO, they will be less likely to perform a control role. On the other hand, as outsider directors are not part of the organization's management team, they are less exposed to the same potential conflicts of interest that are likely to affect the judgments of insider directors (Kosnik, 1987). Therefore, agency theory suggests that outside directors, being detached from management, facilitate objectivity in board's control role, and that boards with more outsiders become more effective than those with a lower proportion. (Johnson et al., 1996; Sundaramurthy and Lewis, 2003).

From a resource provision perspective, a greater proportion of outside directors on the board enhances the base of expertise that top management can draw on in the formulation of critical strategic decisions (Zahra, 1996). In addition, resource provision theory values inside directors for their operational expertise and information about intended strategic initiatives (Forbes and Milliken, 1999; Stiles, 2001; Langevoort, 2001; Carpenter and Westphal, 2001). A board comprised predominantly of non-executive directors may be less effective from a resource provision perspective because outside board members might not have enough knowledge of business, expertise and access to information to provide a significant strategic contribution (Stiles, 2001). Therefore, boards with a mix of both inside and outside board members might be more effective than boards dominated by outsiders. Given that the control role will be more pronounced in firms with dispersed ownership, and the direction role more

important in firms with concentrated ownership, the effectiveness of proportion of outside board members is likely to depend on the ownership structure:

Proposition 1: For firms with dispersed ownership, the relationship between the proportion of outside board members and board effectiveness will be positive, while this relationship is unclear for firms with concentrated ownership.

Empirical studies have found no consistent evidence to suggest that increasing the percentage of outside board members on the board will enhance board effectiveness or firm performance. If anything, they suggest that pushing too far to remove inside and affiliated directors may harm firm performance by depriving boards of the valuable firm and industry-specific knowledge they provide (Fama and Jensen, 1983; Baysinger and Hoskisson, 1990). A few studies have identified a positive relationship between the percentage of outside directors and firm performance (Schellenger, Wood and Tashakori, 1989; Pearce and Zahra, 1992; Daily and Dalton, 1993), while other studies found no significant relationship between board composition and company performance (Mallette and Fowler, 1992; Daily and Johnson, 1997; Bhagat and Black, 1999; Hermalin and Weisbach, 1991; Klein, 1998; Dulewicz and Herbert, 2004). Dalton et al. (1998) conducted meta-analyses of the research on board composition and performance. Their analysis of 54 studies shows no evidence of a link between the proportion of outside board members and company financial performance and shows that neither the size of the company nor the measures used for director type or company performance, affected the findings.

Table 1.1: Comparing the Board recommendations in the Anglo-Saxon context (UK) with the Continental European Context (Spain and Italy)

	UK	Italy	Spain
Date of Introduction	2003; revised 2006	1999; revised in 2002 and 2006	2005; revised 2006
Character	Comply or Explain	Best practice	Comply or Explain
Outside Board members	Except for smaller companies, at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent.	An adequate number of non-executive directors shall be independent, in the sense that they do not maintain, nor have recently maintained, directly or indirectly, any business relationships with the issuer or persons linked to the issuer, of such significance as to influence their autonomous judgement.	External directors, proprietary and independent, should occupy an ample majority of board places, while the number of executive directors should be the minimum practical bearing in mind the complexity of the corporate group and the ownership interests they control.
Single/dual leadership	The roles of chairman and chief executive should not be exercised by the same individual. The division of responsibilities between the chairman and chief executive should be clearly established, set out in writing and agreed by the board.	It is appropriate to avoid the concentration of corporate offices in one single individual. In the event that the chairman of the board is the CEO of the company, the board must designate a lead independent director who represents a reference and coordination point for the requests and contributions of non-executive directors and, in particular, those who are independent	When a company's Chairman is also its chief executive, an independent director should be empowered to request the calling of board meetings or the inclusion of new business on the agenda; to coordinate and give voice to the concerns of external directors; and to lead the board's evaluation of the Chairman.
Board size	The board should be of sufficient size that the balance of skills and experience is appropriate for the requirements of the business and that changes to the board's composition can be managed without undue disruption.		In the interests of maximum effectiveness and participation, the Board of Directors should ideally comprise no fewer than five and no more than fifteen members
Board tenure	Any term beyond six years for a non-executive director should be subject to particularly rigorous review. Non-executive directors may serve longer than nine years, subject to annual re-election.	A board members is not considered independent if he/she was a director of the listed company for more than nine years in the last twelve years	Independent directors should not stay on the board for a continuous period of more than 12 years.
Board directorships	The board should not agree to a full time executive director taking on more than one non-executive directorship in a FTSE 100 company nor the chairmanship of such a company.	The board shall issue guidelines regarding the maximum number of offices as director or auditor that may be considered compatible with an effective performance of a director's duties.	Companies should require their directors to devote sufficient time and effort to perform their duties effectively.

Table 1.1 gives a comparative overview of the recommendations related to the different aspects of the board in these three countries, comparing the Anglo-Saxon context (UK) with the Continental European Context (Spain and Italy). Both the UK and the Spanish code recommend that at least half of the board should be composed of outside (non-executive) board members. The Spanish code however argues that the exact number of executives may depend on the ownership structure of the company. The Italian Corporate Governance code does not provide any recommendation about the proportion of outside board members, and only states that an adequate number of the non-executives should be independent. Considering European economies, Heidrick and Struggles (2009) reveals that the average values of board independence are much larger for UK listed companies, prevalently firms with dispersed ownership, than for listed companies from Continental Europe, prevalently firms with concentrated ownership. These findings provide support for our proposition 1. Table 1.2 gives an overview of the summary results for Heidrick and Struggles (2009) concerning a number of board related issues for the UK, Spain, France, Italy, Belgium, Sweden and Portugal, countries with a comparable (unified) board structure.

Table 1.2: Board characteristics in European countries with a unified board structure

Table 1.2 gives an overview of the key results of Heidrick and Struggles (2009) concerning a number of board related issues for the UK, Spain, France, Italy, Belgium, Sweden and Portugal (countries with a comparable board structure)

	UK	Spain	France	Italy	Belgium	Sweden	Portugal
Average Board Size	8.5	14.3	14.6	13.4	12.7	10.8	13.0
Independent non-executive directors	86%	30%	42%	45%	40%	45%	22%
Reference directors	1%	43%	17%	12%	32%	16%	26%
Single leadership	0%	60%	42%	13%	15%	16%	30%
A non-executive chairman is the former CEO	6%	9%	30%	13%	20%	0%	25%
Average time on the board	4.2	6.1	6.8	4.2	6.7	6.7	4.8

1.3.2 Single/Dual leadership

CEO dominated boards are likely to exist when the CEO and the chairman of the board are the same person, i.e., single leadership. The single leadership structure breaks the balance of powers between the top management and the board of directors, potentially restricting the board's effectiveness in controlling managerial initiatives and actions (Boyd et al., 2005). Furthermore, single leadership increases information asymmetry between the CEO and the board, which may become a primary source of agency problems (Eisenhardt 1989). Adams and Ferreira (2007) state that the CEO faces a trade-off in disclosing information to the board because with better information comes better advice, but a better informed board may also monitor the CEO more intensively. If the role of the board is control, the CEO may be reluctant to share information. CEOs who also operate as chairmen can more easily tailor content and information to the boardroom. As a result, single leadership can influence on the board decision-making processes. Therefore, combining the positions of CEO and board chairperson weakens boards' effectiveness in controlling and monitoring functions (Aguilera 2005). However, the CEO may enhance the information flow towards the board members when the board's role is to assist management strategically rather than control its actions. Better communication and increased levels of disclosure could increase the understanding between management and board members (Forbes and Milliken, 1999; van Ees et al., 2009) and improve board effectiveness. Given that the control role will be more pronounced in firms with dispersed ownership, and the direction role more important in firms with concentrated ownership, the effectiveness of dual leadership is likely to depend on the ownership structure:

Proposition 2: For firms with dispersed ownership, dual leadership will be more effective, while single leadership will be more effective for firms with concentrated ownership.

The results of research on the effects of dual leadership on board effectiveness or company performance are ambiguous (Finegold, Benson and Hecht, 2007). Most studies using stock market measures have found no significant effects (Daily and Dalton, 1992, 1997; Baliga et al., 1996; Brickley et al., 1997). Studies that have looked at financial measures have shown mixed results, some indicating that single leadership enhanced performance (Daily and Dalton, 1994b; Donaldson and Davis, 1991; Kiel and Nicholson, 2003), while others (Coles, McWilliams and Sen, 2001; Rechner and Dalton, 1991) have shown a negative impact.

While the UK combined code explicitly argues in favor of a separation of the CEO and the chairman position, both the Spanish Unified code and the Italian Corporate Governance code, recognizing that single leadership has both advantages and disadvantages, do not demand a strict separation of the two positions. Heidrick and Struggles (2009) show that single leadership is much more frequent in Spain, France or Italy, compared to the UK and that the chairman is often a former CEO in France, Belgium or Portugal, but much less frequent in the UK or Sweden. These findings support the idea that firms where dispersed ownership is prevalent benefit from dual leadership, while single leadership may be more effective in firms in firm where concentrated ownership is more frequent.

1.3.3 Board of directors' size

Social psychology literature indicates that larger sized groups may experience communication and coordination problems (Shull et al., 1970). Smaller groups, on the other hand, have been found to be more cohesive (Shaw, 1981) and may be able to reach consensus faster than larger groups (Priem, 1990). Jensen (1993) states that keeping boards small can help improve their effectiveness to control management since boards are easier for the CEO to dominate, when they get beyond seven or eight people. A contrary position is provided by the resource dependence perspective that argues that large boards may be more effective as a

result of enhancing the ability of the firm to establish external links with the environment, securing more rare resources and bringing more exceptional qualified counsel, experience and expertise to advise the CEO and management (Dalton et al., 1999). Furthermore, a large board size may improve the efficiency of decision making process as a result of information sharing (Lehn, Sukesh and Zhao, 2003). Given that the control role will be more pronounced in firms with dispersed ownership, and the direction role more important in firms with concentrated ownership, the effectiveness of board size is likely to depend on the ownership structure:

Proposition 3: For firms with dispersed ownership, smaller boards will be more effective, while larger boards will be more effective for firms with concentrated ownership.

There has been relatively little empirical research that has directly focused on the impact of board size on board effectiveness or firm performance that could help determine the validity of these two perspectives. While Yermack (1996) and Bøhren and Ødegaard (2001) found that firms with smaller boards have a better performance, other authors offered supportive evidence for the positive influence of large board size (Dalton et al., 1999; Kiel and Nicholson, 2003; Bozec and Dia, 2007). Kaymak and Bektas (2008), on the other hand, have found no relationship between board size and corporate performance. In addition, Dalton et al. (1999) conducted a meta-analysis of 27 studies that featured a board size variable and found that having more directors was associated with higher levels of firm financial performance. In contrast, De Andres, Azofra and Lopez (2005) analyzed ten developed markets, including the United States, and found a negative relationship between board size and firm performance as measured by 12-month equity market-to-book value.

The UK combined code argues that "the board should be of sufficient size, that the balance of skills and experience is appropriate for the requirements of the business and that changes to the board's composition can be managed without undue disruption". The Italian code on the other hand, does not include any recommendation regarding the size of the board. Finally, the Spanish unified code is very specific about the limits of an optimal board, arguing that "boards should ideally comprise no fewer than five and no more than fifteen members". Heidrick and Struggles (2009) show a clear difference between the average board size of UK listed companies and the average board size of Spain, France, Italy, Belgium or Portugal. UK boards are composed, on average, of 8.5 members, while Continental European boards have, on average, about 13 board members. These country-level comparisons seem to support our proposition 3 with respect to the influence of ownership structure on board size effectiveness.

1.3.4 Directors' tenure

There are conflicting views regarding the effect of director tenure on director effectiveness. The expertise hypothesis suggests that a long-term director engagement is associated with greater experience, commitment, and competence, because it provides a director with important knowledge about the firm and its business environment. Vance (1983) argues that forcing directors to retire leads to a waste of talent and experience. Similarly, Buchanan (1974) finds that extended tenure enhances the organizational commitment and the willingness to expend effort toward company goals. Kor and Mahoney (2000) argue that experiential knowledge of a firm is vital for boards to effectively guide the firm's future directions. During tenure on a specific board, outside directors develop the knowledge of a firm's past commitments and unique resources and capabilities that helps them assess the viability of growth proposals presented by management. With firm-specific knowledge, outside directors can speak a common language and integrate and exploit their knowledge more efficiently (Grant, 1996; Nahapiet and Ghoshal, 1998; Postrel, 2002). In addition,

outside directors are able to build internal social capital (Fischer and Pollock, 2004) in the form of knowledge of each other and of firm's top-level executives when their time on the board increases. Increased familiarity between outside directors and executives allows directors to better interpret the information received from management and fosters interpersonal trust (Sundaramurthy and Lewis, 2003; Westphal, 1999), leading to higher board's effectiveness.

Vafeas (2003) propose a management friendliness hypothesis, suggesting that seasoned directors are more likely to befriend, and less likely to control managers. Extended tenure of outside directors in a specific firm board can result in less communication and openness to outside information, increased commitment to a certain view of the firm, including its opportunities and challenges, and resistance to major changes in firm's strategic direction (Boeker, 1997; Hambrick and Fukutomi, 1991; Miller, 1991). In time, outside directors may be co-opted by management as directors become less mobile and less employable. We argue that the risk of becoming less effective as the time on the board increases is more severe when the role of the board is to control management. The main advantages in favor of long term engagement are linked with strategic advice and the provision of resources in general, while the main disadvantages are linked to the threat of a loss of critical judgment and control. Given that the control role will be more pronounced in firms with dispersed ownership, and the direction role more important in firms with concentrated ownership, the effectiveness of the board directors' tenure is likely to be influenced by the ownership structure:

Proposition 4: For firms with dispersed ownership, shorter board tenure will be more effective, while longer board tenure will be more effective for firms with concentrated ownership.

The literature on the relationship between board tenure and board effectiveness or firm performance is relatively scarce and mainly focused on large Anglo-American companies. In their investigation of the US banking industry, Mishra and Nielsen (1999) found that the tenure of outside board members was negatively associated with growth opportunities. Finally, Hermalin and Weisbach (1988) show that the median tenure of directors is negatively associated with the market value of US firms.

The UK combined code argues that any term beyond six years for a non-executive director should be subject to particularly rigorous review and that serving more than nine years could be relevant to the determination of a non-executive director's independence. The Italian and Spanish codes are less strict with respect to the board terms. The Italian code stipulates that a director serving more than nine years in the last twelve years cannot be considered independent; while the Spanish code prescribes that independent directors should not be on the board for a continuous period of more than 12 years. Heidrick and Struggles (2009) reveals that UK board members serve on average 4.2 years, which is fewer compared to Spain, France, Belgium or Sweden, but not very different from the Italian or Portuguese average.

1.3.5 Multiple directorships

On the positive side, multiple directorships can add value by enhancing executive experience (Carpenter and Westphal, 2001) and by permitting the executive to establish a network or to use business relations (Mace, 1986; Loderer and Peyer, 2002). Applied to the

context of interlocking directorates, board directors can be seen as important boundary spanners that link with the environment and extract resources for successful operations, and therefore, firms using interlocking directorates could achieve better coordination with other organizations and reduce uncertainty (Burt 1983). O'Neal and Thomas (1996) argue that the distinct sources of director capital (i.e., multiple board experience and managerial industry experience) are uniquely valuable, but complementary to each other in dynamic environments. In that sense, multiple-board relationships may offer firms access to information and resources. Furthermore, Khwaja et al. (2008) find that having directors who sits on many other boards can improve a firm's network and, hence, add value. Adams, Hermalin and Weisbach (2009) argue that the importance of this effect is possibly greater in a developing country than in a developed country. In addition, O'Neal and Thomas (1996) illustrate the dominant role which director networks play in at least one vitally-important board process--director selection. Directors' personal, social, business and professional networks (including multiple-board relationships), are the primary source of board-seat candidates.

On the negative side, multiple directorships may lower the effectiveness of outside directors as corporate monitors (Core et al., 1999; Shivdasani and Yermack, 1999). Core et al. (1999) report that busy outside directors provide CEOs with excessive compensation packages, which in turn leads to poor firm performance. In addition, Ferris et al. (2003) and Fich and Shivdasani (2006) contend that directors holding a large number of outside board seats may be overcommitted, thereby causing poor board effectiveness. We argue that board focusing on the provision of resources probably benefit from multiple directors positions, as it allows directors to build a diverse knowledge base on strategic and governance issues. Boards focusing on monitoring are less likely to benefit from multiple board positions as one of the

main disadvantages refers to a loss of focus and time dedicated to monitoring, while the benefits of multi directorships apply much less to the control role. Given that the control role will be more pronounced in firms with dispersed ownership, and the direction role more important in firms with concentrated ownership, the effectiveness of board directorships is likely to be influenced by the ownership structure:

Proposition 5: For firms with dispersed ownership, less board directorships will be more effective, while more board directorships will be more effective for firms with concentrated ownership.

Several studies examining the link between broad multiple board seats and board effectiveness or firm performance have produced ambiguous results (Ferris et al., 2003; Fich and Shivdasani, 2006; Perry and Peyer, 2005; Jiraporn et al., 2008). For a sample of US firms, Fich and Shivdasani (2006) find a negative impact of busy boards on monitoring while Core et al. (1999) report that the presence of directors holding multiple appointments correlates with excess CEO compensation. In addition, Adams and Ferreira (2008) show that directors with more directorships are more likely to have attendance problems at board meetings, which suggests that busy directors spend less time at each firm. Other evidence suggests that multiple director positions are associated with firm success (Ferris et al, 2003; Miwa and Ramseyer, 2000; Cotter et al., 1997). Bøhren and Strøm (2007) find for a Norwegian dataset that corporate performance, as measured by Tobin's Q, is significantly higher when directors have wide networks through seats they hold in other firms. Considering French firms, Yeo et al. (2003) find a positive relationship between the number of CEOs reciprocal interlocks and their firms' performance, measured by ROA.

The UK Combined code restricts executive directors from taking more than one non-executive directorship in a FTSE 100 company or the chairmanship of such a company, to ensure that board members have enough time available to devote to the job. The Spanish and the Italian Corporate Governance codes, on the other hand, only recommend that directors should devote sufficient time and effort to perform their duties, without explicitly restricting the number of directorships.

1.4 Discussion and policy implications

The review of the empirical research on the characteristics of the board of directors shows that results are often inconclusive. One reason for the mixed empirical results related to the effectiveness of various governance mechanisms may be the neglect of patterned variations in corporate governance according to the contexts of different organizational environments (Filatotchev, 2008). Universalistic policy prescriptions could therefore lead to important shortcomings and, as a result, they need to be substantially adapted to the local contexts of firms or translated across diverse national institutional settings (Fiss and Zajac, 2004; Aguilera and Cuervo-Cazurra, 2004). Building on organizational theory and institutional analysis a number of more recent studies attempt to develop a framework for understanding the influence of organization-environment interdependencies on the effectiveness of corporate governance in terms of the firm's contingencies, complementarities between governance practices and potential costs of corporate governance (e.g., Aguilera et al. 2008; Filatotchev et al. 2006; Aguilera and Jackson, 2003). Our study builds on these arguments and suggests that the effectiveness of a specific corporate governance practice must also be seen in the light of contingencies related to the ownership structure of the firm. The objective of this paper is to understand how the role of the board of directors (control versus direction) is influenced by the ownership structure and a how a different role influences the board effectiveness. While shareholders in firms with dispersed ownership

have a great need to use the board of directors to control the management, large controlling shareholders have both the incentive and the power to hold management accountable. The control role of the board is therefore considered to be less important in the presence of concentrated ownership (La Porta et al., 1998; Aguilera, 2005). In this study, we argue that the ownership structure, through the role of the board of directors, influence the effectiveness of the board of directors.

An important implication is that effectiveness does not result from a universal 'one best way', but suggests that particular practices will be effective only in certain combinations and furthermore may give different patterns of comparative institutional advantages given the contingencies of different environments. In the context of this study, firms with dispersed ownership may obtain higher board effectiveness if their board combines the following characteristics: a high proportion of outside board members, dual leadership, smaller board size, shorter board tenure and less directorships by its board members. The board in a firm with concentrated ownership on the other hand could be more effective when the board combines the following characteristics: a balance of insiders and outsiders, single leadership structure, larger board size, longer board tenure and more directorships by its board members. Table 1.3 presents an overview of the suggested board characteristics that could work best for firms with dispersed or concentrated ownership.

The framework suggests that corporate governance recommendations and policy making will be more effective if they take into account the potential diversity of governance mechanisms, which deal with important contingencies. Codes of corporate governance need to be sufficiently flexible to be effective. In addition, from the comparison between the UK, Italian and Spanish codes of corporate governance, it is clear that codes reflect to some extent

the specific corporate governance setting within a country. Although within a country, less consideration has been given to the diversity and different needs. Understanding the influence of the board of directors on board effectiveness requires greater sensitivity to how corporate governance affects different aspects of effectiveness for different stakeholders and in different contexts. We argue 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 interested in applying corporate governance in particular situations.

Table 1.3: Ownership structure and suggested board characteristics

	Firms with dispersed ownership	**Firms with Concentrated ownership**
Primary role of the Board	Control	Direction
Outside Board members	Primarily outsiders	Both insiders and outsiders
CEO - Chairman	Dual leadership	Single leadership
Board size	Small boards	Large boards
Board tenure	Limited board tenure	Extended board tenure
Board directorships	Limited board directorships	Extended board directorships

1.5 Conclusions

This paper develops a theoretical model to better understand how the role of the board of directors (control versus direction) is influenced by the ownership structure and a how a different role influences the board effectiveness. Most corporate governance research focuses on a universal link between corporate governance practices (e.g., board structure, shareholder activism) and performance outcomes, but neglects how the specific context of each company and diverse environments lead to variations in the effectiveness of different governance practices. An important question addressed in this paper is whether all firms, regardless of

their ownership structure, should be submitted to the 'one-rule-fits-all' recommendations of a majority of non-executive directors, a separation of CEO and chairman and restrictions regarding the board size, the terms of board members and the number of board positions held in other companies. This study suggests that the effectiveness of a specific corporate governance practice must also be seen in the light of contingencies related to the ownership structure of the firm. When ownership is diffuse, the control role of the board is going to be more important because it is difficult for the dispersed shareholders to co-ordinate their monitoring activities (Davies, 2002; Aguilera, 2005). Firms with dispersed ownership may obtain higher board effectiveness if their board combines the following characteristics: a high proportion of outside board members, dual leadership, smaller board size, shorter board tenure and less directorships by its board members. The board in a firm with concentrated ownership on the other hand could be more effective when the board combines the following characteristics: a balance of insiders and outsiders, single leadership structure, larger board size, longer board tenure and more directorships by its board members.

Chapter 2

Board Characteristics and Audit Fees: Why Ownership Structure matters.

2.1 Introduction

Building on organizational theory and institutional analysis a number of recent studies have developed a framework for understanding the influence of organization-environment interdependencies on the effectiveness of corporate governance in terms of the firm's contingencies, the complementarities between governance practices and the potential costs of corporate governance (e.g., Aguilera et al. 2008; Filatotchev et al. 2006). These studies argue that effective corporate governance depends upon the alignment of interdependent organizational and environmental characteristics. Adopting a wide range of research perspectives and theoretical approaches they help to explain why, despite some universal elements, no 'one best way' exists to achieve effective corporate governance. Rather, the notion of corporate governance as a system of interrelated elements having strategic or institutional complementarities suggests that particular practices will be effective only in certain combinations and, furthermore, they may give different patterns of comparative institutional advantages given the contingencies of different business strategies or industry environments (Aguilera et al. 2008; Adams and Ferreira, 2007).

External auditors are considered an important piece of the corporate governance puzzle because they are an essential component to guarantee the protection of investors'

rights. More precisely, they attest that all shareholders are equally treated and that financial statements are in conformity with contractual commitments. Thus, external auditors improve the confidence of investors in financial reporting, facilitate the assessment of the objective situation of the firm, and increase fund-raising possibilities. The auditor considers the board, who reviews the overall planned audit scope and the audit fee, as its client (Blue Ribbon Committee, 1999). Furthermore, 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 interests of the company and the shareholders. In most countries (e.g., Canada, France, Germany, Italy, Mexico, Spain, Switzerland, the UK and the US), these fiduciary duties take the form of statutory obligations, with some of them (e.g., Canada, and the US) having extensive case law and jurisprudence on their actual application (Aguilera and Cuervo-Cazurra, 2009). In this sense, Carcello et al. (2002) argue that the board of directors may seek to protect its reputational capital to avoid legal liability and to promote shareholders' interests by putting pressure on the CEOs and management in requesting more audit services. They find that independent boards are successful at enhancing the audit scope, while boards dominated by executives are more dormant and demand fewer external audit services.

An extensive body of literature has emerged examining the level and nature of audit fees in organizations (e.g. O'Sullivan, 2000; Carcello et al. 2002, Abbott et al. 2003). Hay, Knechel and Wong (2006) conducted a meta-analysis of the 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. These authors also suggest that, on the basis of their observations about anomalies, inconsistencies, and gaps in the previous literature, future research should study

how different forms of ownership and local institutional structures affect audit fees across companies.

Despite the integration of financial markets, corporate financing and governance practices remain very different in Continental European countries compared to the US or the UK (Aguilera et al. 2008; Enriques and Volpin, 2007). For example, the UK and the US are characterized by dispersed ownership where markets for corporate control, legal regulation, and contractual incentives are key governance mechanisms. In continental Europe, large controlling shareholders retain greater capacity to exercise direct control and, hence, operate in a context with fewer market-oriented rules for disclosure, weaker managerial incentives, and greater supply of debt. Therefore, drawing on a sample of large Continental European firms allows us to investigate the relationship between the board of directors and external audit in a non-Anglo-Saxon institutional environment where firm ownership is generally much more concentrated and shareholder rights are weak (La Porta et al. 1997). Additionally, focusing on companies from Continental Europe with a tradition of low litigation risk also allows us to test the importance of the lack of director's legal liability on the level of external audit.

The existing studies considering the link between board characteristics and audit fees typically invoke an agency approach, which assumes that the board's main objective is to control management. Zahra and Pearce (1989) and Hillman and Dalziel (2003) argue that the two main functions of the board of directors are control and resources provision (e.g., legitimacy, advice and counsel, links to other organizations, etc.). Therefore, boards are faced with an apparent paradox in that, on the one hand, they are expected to exercise control over the top management so that interests of shareholders (and other stakeholders) are protected;

and on the other hand they need to work closely with the top management to provide valuable support in choosing corporate strategy and make informed decisions in implementing strategy (Hillman and Dalziel, 2003; Sundaramurthy and Lewis, 2003). The primary role of the board of directors is not independent from the context in which the company operates. The control role of the board is going to be more important when ownership is diffuse because it is difficult for the dispersed shareholders to co-ordinate their monitoring activities (Davies, 2002; Aguilera, 2005). Since large shareholders have both the incentive and the power to hold management accountable for actions that do not promote shareholder value (Bohinc and Bainbridge, 2001), the control role of the board, in such a situation, is considered to be less important (La Porta et al., 1998; Aguilera, 2005). In this paper, we argue that the ownership structure changes the behavior of the board of directors. Boards in firms with dispersed ownership, with a strong focus on control are more likely to favor a higher demand of audit services relative to boards in firms with ownership concentration, where the board's emphasis is on the provision of resources to management. The proposed model is illustrated in Figure 2.1.

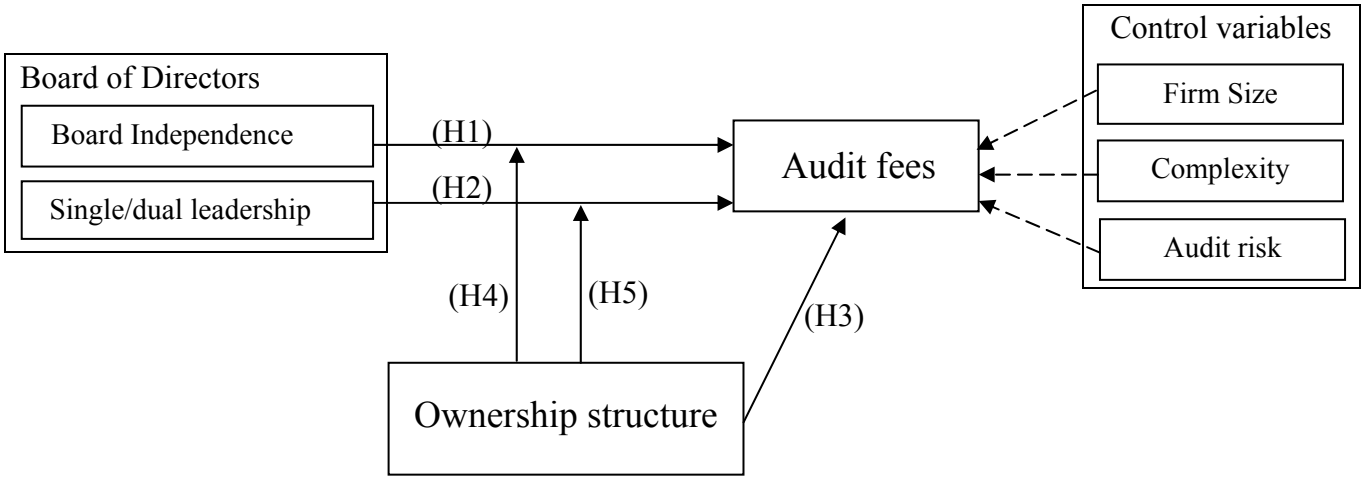

Figure 2.1: The relationship between ownership structure, board composition and external audit services

The interests of the paper are both theoretical and practical. From a theoretical viewpoint, this study offers greater insight into the influence of the ownership structure on corporate governance mechanisms. Aguilera et al. (2008) and Aguilera and Jackson (2003) explain the importance of organization-environment interdependencies on the effectiveness of corporate governance. One reason for the mixed empirical results related to the effectiveness corporate governance may be the neglect of patterned variations in corporate governance according to the contexts of different organizational environments. Likewise, recent critiques of agency theory have centered on it being too 'under-contextualized' to compare and explain the diversity of corporate governance arrangements across different organizational or national contexts (Aguilera et al. 2008). Our study builds on these arguments and suggests that the relationship between different corporate governance practices must also be seen in the light of contingencies related to the ownership structure of the firm. The results of this study imply that the effectiveness of corporate governance mechanisms is likely to differ contingent upon the ownership structure. From a practical viewpoint it provides insight into the limited generalizability of corporate governance studies conducted in an Anglo-American framework for Continental European economies, by empirically showing that the influence of the board of directors on the demand for external audit is contingent on the ownership structure. In addition, our results add to the comparative corporate governance literature by showing how the ownership structure may help to explain cross-national differences in governance practices.

This paper also has implications for policymakers and the corporate governance reforms made after the accounting scandals in the United States (Enron, WorldCom, Adelphia) and in Europe (Parmalat). The rather universalistic policy prescriptions may lead to important shortcomings and, as a result, they need to be substantially adapted to the local

contexts of firms or translated across diverse national institutional settings (Filatotchev 2008). This study highlights the influence of the organizational environment on the behavior of the board of directors. Our results show that regulation merely focusing on board independence may not be effective since a similar degree of board independence may lead to different behavior depending on the ownership structure. Finally, focusing on companies from countries with a lower risk of lawsuits against board members also permits testing the importance of the director's legal liability on the demand for audit.

2.2 Prior research and theoretical framework

Francis (2004) points out that it is difficult to assess audit quality, because the only observable outcome of the audit is the audit report. The problem with audit reports in this context is that audit reports follow a generic template and that most reports are standard clean opinions. Butler et al. (2004) report, that only 6.6 % of US firms received a modified audit report during 1994 - 1999. Previous literature has extensively focused on the audit fees and the size of the audit firm to measure audit quality. Using the audit fees as a proxy for quality can be justified for a number of reasons. First, it is reasonable to assume that more investigation will require more audit hours and/or the use of more specialized audit staff, resulting in higher fees (O'Sullivan, 2000; Carcello et al. 2002; Abbott et al. 2003). Second, existing audit pricing studies acknowledge the link between audit quality and pricing by including a binary variable to represent 'big 6-5-4' auditors. It is suggested that these firms are higher quality auditors and consequently are expected to charge a premium for their expertise (Palmrose, 1986; Chan et al., 1993). Third, the link between audit quality and fees has been raised both by Cadbury (1992) and the Chartered Accountants' Joint Ethics Committee (1993) and both reports warn against the likelihood that audit quality may be compromised by low fees. The notion that audit fees reflect audit quality is also supported by empirical research which has documented a positive relation between audit fees and financial

information quality. For example Frankel et al. (2002) and Larcker et al. (2004) found that higher fees paid to auditors are associated with smaller accruals. In addition, Geiger et al. (2003) found a positive association between audit fees and qualified audit opinions, which implies that additional audit effort results in more accurate audit opinions. In summary, the results of the above studies imply that audit firms receiving higher fees also provide higher actual and perceived audit quality.

An extensive body of literature has developed related to the level and nature of audit fees in organizations. The original seminal work by Simunic (1980) spawned an expanding body of literature that has examined a large number of possible drivers of audit fees. Numerous general conclusions can be drawn from this literature, e.g., audit fees are influenced by factors related to the size of the organization, complexity of its operations and the audit risk. In addition, numerous studies have reported a positive relationship between the quality of corporate governance and audit fees (O'Sullivan, 2000; Carcello et al., 2002; Abbott et al., 2003; Knechel and Willekens, 2006 and Hay, Knechel and Wong, 2004). The findings that audit fees are often higher when the control environment is otherwise considered to be effective cannot be explained within a production orientation since there is no obvious explanation why an auditor should bear more risk or perform more testing (Knechel and Willekens, 2006). In fact, following a production view, good corporate governance, such as the presence of outside board members, should improve the control environment and reduce the need for external auditing, leading to a reduction in audit fees. To justify a production perspective of the audit services, Hay, Knechel and Wong (2006) argue that two strong assumptions are needed: (1) the market for audit services is competitive and (2) the level of assurance delivered is constant within a firm, implying that audit fees are a function of cost. These assumptions may not be robust for the market for audit services and the anomalies with

respect to relationship between corporate governance and audit fees may be due to omitted demand factors and the endogeneity of decisions about alternative controls (Hay, Knechel and Wong, 2006). If the market for audit services is not generally competitive or levels of assurance vary across engagements, differential demand forces can lead to variations in audit fees that are not production related.

The empirical results are consistent with an increased demand for external auditing. Knechel and Willekens (2006) argue that the demand for external audit services is presumed to be dependent on the interaction of (1) the set of risks affecting the individual stakeholders of an organization and (2) the set of control mechanisms that are available to reduce the effect of those risks. Risks and controls will vary across stakeholders. Because individual decisions about control processes and procedures may shift benefits and costs across groups of stakeholders, the net investment in auditing may increase when multiple stakeholders become involved in corporate governance decisions. For example, outside directors may demand more auditing in order to fulfill their responsibilities and protect their own reputations against questionable financial reporting decisions made by management. Furthermore, the cost of the audit is most likely to be borne by the equity shareholders who may have little say in determining the extent of audit work undertaken (Carcello et al., 2002). As a result, investment in external auditing may exceed that necessary to simply reduce information risk to an acceptable level for other stakeholders.

2.2.1 Board independence and external audit fees

Agency theory argues that an impartial assessment of managers will occur more readily if the board is independent of the executive management. Since the insider directors are subordinates of the CEO, they will be less likely to perform a control role. On the other hand, as outsider directors are not part of the organization's management team, they are less

subjected to the same potential conflicts of interest that are likely to affect the judgments of insider directors (Kosnik, 1987). Therefore, agency theory suggests that outside directors, being detached from management, facilitate objectivity in board's control role (Johnson et al., 1996; Sundaramurthy and Lewis, 2003). In line with previous studies on the relationship between board composition and audit fees, we define independence as the proportion of outside (i.e. non-executive) board members. Hay and Knechel (2004) argue that an independent board will be more concerned about discharging its control role and, therefore, will put pressure to enhance 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 misbehavior that could affect their personal liability. Furthermore, independent board members reduce their responsibilities, without bearing the costs (Carcello et al., 2002). This suggests that companies with greater board independence will seek a more comprehensive audit.

H1: There is a positive relationship between board independence and external audit fees.

2.2.2 Single leadership and external audit fees

CEO dominated boards are likely to exist when the CEO and the chairman of the board are the same person, i.e. single leadership. The single leadership breaks the balance of powers between the top management team and the board, potentially restricting the board's effectiveness in controlling managerial initiatives and actions (Boyd et al., 2005). Furthermore, single leadership increases the information asymmetry between the CEO and the board, which may become a primary source of agency problems (Eisenhardt 1989). CEOs have superior knowledge regarding the industry and the firm's internal conditions and CEOs who also serve as the board's chairman can more easily tailor content and information to the

boardroom. As a result, a single leadership can influence the board decision-making processes. Therefore, combining the positions of CEO and board chairperson weakens boards' effectiveness in monitoring functions (Aguilera, 2005).

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 1992). In addition, Gul and Leung (2004) show that single leadership is associated with lower voluntary disclosure. 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 with respect to the use of company 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-executive directors are expected to have reduced influence in seeking an intensive audit, and consequently companies with single leadership are more likely to request a lower demand for external audit (O'Sullivan, 2000).

H2: There is a negative relationship between single leadership and external audit fees

2.2.3 Ownership structure and external audit fees

Agency theory postulates that the demand for audits is directly related to the extent of the separation between ownership and control. For a sample of UK listed companies, Chan et al. (1993) hypothesize and document an inverse association between ownership concentration and audit fees. O'Sullivan (2000), also considering UK listed firms, shows that audit fees are negatively related to the proportion of equity owned by executive directors, but finds no evidence that ownership by large blockholders (institutional or otherwise) has a significant

impact on audit fees. Mitra et al. (2007) study US listed firms and find evidence of a significantly positive relationship between diffused institutional stock ownership (i.e., having less than five percent individual shareholding) and audit fees, and a significantly negative relationship between institutional blockholder ownership (i.e., having five percent or more individual shareholding) and audit fees. The authors also document a negative relationship between managerial stock ownership and audit fees. These findings are consistent with the view that ownership concentration reduces the demand for assurance. Since large influential owners are able to reduce the information asymmetry they face, they reduce the need for external audit. Also, as controlling owners often operate as managers, and managers who have a large share of his wealth invested in the company are likely more risk averse in making investment decisions than the managers who have a more diversified portfolio (Jensen, 1986). The management's risk-taking behavior could have an impact on audit effort through the auditor's risk assessment and the audit fee. In sum, firms with concentrated ownership are expected to be characterized by lower information asymmetry between the large influential owners and management, which should result in lower audit fees:

H3: There is a negative relationship between concentrated ownership and external audit fees.

2.2.4 Moderating effect of the ownership structure

Although several studies have shown a positive relationship between the board independence and the external audit fees (O'Sullivan, 2000; Carcello et al., 2002; Abbott et al., 2003; Hay, Knechel and Wong, 2004), we would like to propose that this positive relationship might be moderated by the firm's ownership structure. In particular, we argue that the relationships between board independence and audit fees on the one hand, and single leadership and audit fees on the other hand, are contingent on the concentration of ownership of the firm.

When ownership is diffuse, the control role of the board is going to be more important because it is difficult for the dispersed shareholders to co-ordinate their monitoring activities (and is also not worthwhile for any individual institution to monitor the company on a continuing basis) (Davies, 2002; Aguilera, 2005). Shareholders in firms with dispersed ownership prefer strategies of exit rather than voice to monitor management (Eisenhardt, 1989). To resolve the alignment problem in firms with dispersed ownership, the board primary focuses on the control role. While small shareholders do not have incentives to monitor individually, collectively all shareholders benefit from the control efforts by the board of directors.

Shleifer and Vishny (1986) argue that large shareholders have strong incentives to monitor managers because of their significant economic stakes. Even when they cannot control the management themselves, large shareholders can facilitate third-party takeovers by splitting the large gains on their own shares with the bidder. Large shareholders might have access to private value-relevant information (Heflin and Shaw, 2000), engage with management in setting corporate policy (Bhagat, Black and Blair, 2004; Davies, 2002; Denis and McConnell, 2003), have some ability to influence proxy voting and may also receive special attention from management (Useem, 1996). The control role of the board is considered to be less important when large shareholders have both the incentive and the power to hold management accountable for actions that do not promote shareholder value (La Porta et al., 1998; Aguilera, 2005).

Boards with a strong focus on control are more likely to favor a high demand of audit services relative to boards with an emphasis on the provision of resources to management for a number of reasons. First, board members are hired taking into consideration their abilities or

their resources they can potentially bring to the board. Hence, boards with a focus on the provision of resources are likely to have a higher proportion of board members with strategic skills or resources and fewer board members with financial expertise and monitoring skills. Second, the relationship between the top management and the board members is likely to be less hostile when the role of the board is to assist management strategically rather than control its actions. Adams and Ferreira (2007) state that the CEO faces a trade-off in disclosing information to the board because with better information comes better advice, but a better informed board may also control the CEO more intensively. When a board is considered to be a tough monitor, the CEO may be reluctant to share information with it. However, the CEO may enhance the information flow towards the board members when the board's role is to assist management strategically. In this case, better communication and increased levels of disclosure could increase the understanding between management and board members (Forbes and Milliken, 1999; van Ees et al., 2009), and reduce the need to rely on the external auditor. Third, controlling shareholders often serve as a non-executive board member. They are however better informed, have direct access to management, bear directly the cost of auditing, and have a lesser need to rely on external audit. We therefore argue that the demand for external audit by non-executive board members will be stronger in firms with dispersed ownership than in firms with ownership concentration:

H4: The relationship between board independence and external audit fees is significantly stronger for firms with dispersed ownership relative to firms with concentrated ownership.

According to agency theory, single leadership (i.e. the CEO also serves as the Chairman) creates a strong individual power base, which could impair board independence and the effectiveness of its governing function may thus be compromised. However, Maitlis

(2004) shows that an influential CEO can be a positive force in organizational governance, and may even increase the board's effectiveness. If the board of directors is designed to improve the managerial decision making, the presence of the CEO on the board could improve the information flow towards the board members, as well the interactions and discussions, leading to more valuable advice. We argue that firm's ownership structure has a moderating effect on the relationship between single leadership and the audit fees, for at least two reasons. First, single leadership is likely to be much more important when the board's role is control, with board members looking to enhance the audit scope. When the role of the board is to provide resources and the demand for external audit is low, single or dual leadership will be less important. Second, as argued before, the CEO may enhance the information flow towards the board members when the board's priority is to assist management strategically rather than control its actions. Better communication and increased levels of disclosure could reduce the need for external auditing and increase the understanding between management and board members (Forbes and Milliken, 1999; van Ees et al., 2009). This effect is likely to be even stronger when the CEO is also chairman of the board of directors. Therefore, the relationship between single leadership and the demand for audit may be contingent on the ownership concentration of the firm.

H5: The relationship between single leadership and external audit fees is significantly stronger for firms with dispersed ownership relative to firms with concentrated ownership.

2.3 Sample description and methodology

To test our proposed hypotheses we consider all non-financial firms listed on the Madrid stock exchange (Spain) and the large and mid-sized non-financial 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 fees data and the control variables related to balance sheet information and the complexity of operations come from the Thomson Reuters Worldscope database. The corporate governance data was manually collected from the company annual reports and the corporate governance reports. Finally, the ownership structure data is obtained from the CNMV (Spanish Securities and Exchange Commission, the equivalent to the U.S. Securities and Exchange Commission) database and COFISEM (France). Under the Spanish Companies law, listed companies have the obligation to report the names and shareholdings of shareholders with blocks of shares of five percent or more and any holdings for those that seat in the board of directors to the CNMV. This requirement became active through the Spanish transposition of the European transparency directive (Council Directive of 12 December 1988 (88/627/EEC)). From the files of the CNMV, we analyzed a total of 24.786 communications to determine the ownership structure, considering direct and indirect ownership as well as ownership by different family members for each Spanish listed firm. To illustrate, SOS Cuétara's largest individual shareholders (through direct and indirect shareholdings) include Jesus Ignacio Salazar Bello (16.034 percent) and Raúl Jaime Salazar Bello (9.659 percent). To calculate the ownership stake of the largest shareholder we consider that the family Salazar Bello controls over 25 percent. Similar ownership structure data has been obtained for the French firms using data from COFISEM, the Euro next and the companies' websites.

2.3.1 French and Spanish audit context

Compared with the US, French regulations on auditing display several specific and unique features. First, 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, is intended to provide a twofold perspective on company accounts, and as a result, should reinforce auditor

independence. In practice, 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, 2007). Second, there is a strict separation between the legal audit and consulting services. The new 2003 Financial Security Law has rigorously re-emphasized this principle of separation. As a result, the average amount of non-auditing services is less than five percent for CAC-40 firms (AMF, 2008). Compared to the US or UK, the Sarbanes-Oxley act still allows auditors to provide legal and financial services, and British business ethics law does not forbid auditors from providing management or taxation consulting services for their audit clients. 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 corporate scandals in 2002, various measures have also been undertaken in France, including mandatory publication of audit fees by public companies. This disclosure forces companies to distinguish, on the one hand, between fees paid for legally-required audits and those paid for other services (non audit fees), and on the other hand, the specific fees paid to each of the two independent auditors. Since data on this subject was previously unavailable, very few studies on this subject have been carried out in France.

Spain has a relatively new statutory audit market, since audits are compulsory for all medium and large companies only since the 1988 Spanish Audit Law (SAL). Before 1988, only a few companies, such as state-owned companies and firms in regulated industries, faced compulsory audits. The SAL implemented the provisions of the European Union's eighth directive into Spanish law and constituted the earliest legislation in the country's history that

comprehensively focused on the audit profession (Carrera et al., 2001). The Spanish audit market presents some peculiarities that differentiate it from markets in other countries. Spanish legislation permits hiring the auditor for a minimum of three years and a 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. Additionally, 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. 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 25 percent of the total audit fees stems from non-audit fees. Finally, Spanish 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 geographically spread in both countries, where each Big-4 auditor is 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 Spain and France. 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 often impossible to prove a direct causality between this fault and the damages suffered by the plaintiffs. Further, the US judicial system allows class action suits and contingent fees. According to the Securities Act, it is enough for investors to claim that they trusted audited financial statements when investing in a company, that these statements proved to be deceptive or fraudulent, which caused a drop in stock prices (Menon and Williams, 1994). Class actions and contingent fees are not allowed in France or Spain, and the activism of minority shareholders generally requires a formal association of plaintiffs.

2.3.2 French and Spanish corporate governance context

As noted in the World Bank's 2008 "Doing Business Report", investor protection in both Spain and France is 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 (Extent of Disclosure Index), liability for self-dealing (Extent of Director Liability Index) and shareholders' ability to sue officers and directors for misconduct (Ease of Shareholder Suits Index). The indexes range 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. France scores 10, compared to a score of 5 for Spain, in the disclosure index (US scores 7, while the OECD average is 6.4). With respect to the Director Liability Index, France scores 1 while Spain scores 6 (US scores 9, while the OECD average is 5.1). Finally, France scores 5 in the Shareholder Suits Index, compared to a score of 4 for Spain (US scores 9, while the OECD average is 6.5). The lack of legal protection and the lower development of capital markets explain why these economies exhibit larger levels of ownership concentration as compared to common law countries, and even to Germany and Japan. Fundamental stakeholders in the Spanish and French corporations are families, banks and industrial firms, which have a main role in the ownership structure that influences its corporate governance. The main agency problem arises from controlling and minority shareholders.

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 a Supervisory board (*conseil de surveillance*) and a management board (*directoire*). The two-tier board is similar

to the German model where a supervisory board contains only outside directors and is elected by shareholders, and the management tier contains company executives, who are appointed by the supervisory board. The two-tier structure is infrequent as only two to three percent of all stock corporations and only twenty percent of the CAC 40 companies have opted for a two-tier structure. Recently, the *Loi Nouvelle Régulations Economique*, 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 CEO (i.e. single leadership). 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 our results to prior findings from Anglo-American studies. Our final sample consists of 124 Spanish-listed firms and 118 French-listed firms in 2007.

2.3.3 Model specification

To test our hypotheses, we use a number of ordinary least squares (OLS) regression models, extending the traditional audit fees model (Simunic, 1980; Francis, 1984; Simon 1985; O'Sullivan, 2000; Carcello et al. 2002; Abbott et al., 2003) to include the variables of interest of the present study. It is important to remark that for greater robustness of our estimation, we examined the properties of the errors derived from the different model specifications. In all regressions, results for the Shapiro-Wilks and the Jarque-Bera tests indicate that error terms are normally distributed.

Regression model I (direct effects):

$$\textit{Total audit fees} = \alpha + \beta_1 \textit{ Receivables and inventory} + \beta_2 \textit{ Size} + \beta_3 \textit{ Foreign Sales} + \beta_4 \textit{ Leverage} + \beta_5 \textit{ Diversity of operations} + \beta_6 \textit{ Big 4 auditor} + \beta_7 \textit{ French firm} + \beta_8 \textit{ Ownership concentration} + \beta_9 \textit{ Board independence} + \beta_{10} \textit{ Single leadership} + \varepsilon_1$$

Regression model II (direct and interaction effects):

$$\textit{Total audit fees} = \alpha + \beta_1 \textit{ Receivables and inventory} + \beta_2 \textit{ Size} + \beta_3 \textit{ Foreign Sales} + \beta_4 \textit{ Leverage} + \beta_5 \textit{ Diversity of operations} + \beta_6 \textit{ Big 4 auditor} + \beta_7 \textit{ French firm} + \beta_8 \textit{ Ownership concentration} + \beta_9 \textit{ Board independence} + \beta_{10} \textit{ Single leadership} + \beta_{11} \textit{ Ownership concentration*Board independence} + \beta_{12} \textit{ Ownership concentration*Single leadership} + \varepsilon_2$$

The first regression model is initially tested for the entire sample to test our hypotheses 1, 2 and 3. 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:

Total Audit fees. Following prior studies (Knechel and Willekens, 2006; Carcello et al. 2002, Abbott et al. 2003; O'Sullivan, 2000) on the relationship between corporate governance and audit demand, our dependent variable is the natural log of audit fees. The variable considers the total fees paid for the audit services to all auditors (excluding non-audit fees). The disclosure of audit fees has only recently become compulsory in Spain and France (2003).

Receivables and Inventories. The variable Receivables and Inventories is scaled by total assets and captures partially the complexity of the audit process (Hay, Knechel and Wong, 2006). Receivables and inventories constitute risk categories whose evaluation are complex and requires more in-depth inspection 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 (Hay, Knechel and Wong, 2006).

Size. Since the pioneering publication of Simunic (1980) on this subject, as well as in other international studies (e.g., see Craswell et al., 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. Generally, the bigger companies are involved in a greater number of transactions that necessarily require longer hours for an auditor to inspect.

Foreign Sales. The variable foreign sales is scaled by total sales and captures partially the complexity of the audit process (Hay, Knechel and Wong, 2006). Foreign sales constitutes a risk category 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 more experienced and expensive auditors.

Leverage. 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). Leverage is measured as the total long-term debt divided by total assets.

Diversity of Operations. 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 more experienced and expensive auditors with industry specific knowledge.

Big-4 auditors. 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 are working with one of the 4 large auditors (i.e. KPMG, Deloitte, PwC or EY) or not. This variable takes value 1 if at least one of the auditors is a Big-4 auditor

and 0 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 1 if the firm is listed in France and 0 is the firm lists in Spain.

Ownership concentration. We categorize firms as firms with concentrated ownership, in line with La Porta et al. (1999) and Faccio, Lang and Young (2001), if a person, a family group or a firm has a total stake of at least 20 percent of the shares. Firms without large controlling shareholders are classified as firms with dispersed ownership. To add robustness to our analysis, we use two alternative thresholds (25 percent and 30 percent) as well as two continuous measures (the total shareholdings of the largest and the total shareholdings by the three largest shareholders) to account for the ownership concentration.

Board Independence. We define board independence as the proportion of non-executive board members over the total board size, to be able to compare our results to previous studies using data from an Anglo-Saxon country (e.g. Carcello et al., 2002, Hay and Knechel, 2004).

Single Leadership. A second element of board composition is the single/dual leadership structure. This variable takes the value 1 if the CEO and chairman positions are taken by the same person and 0 otherwise. As mentioned earlier, single leadership is generally perceived as compromising the independence of the board since one individual possesses a great amount of power and authority (Jensen, 1993).

2.4 Results

In this section we first provide descriptive statistics of our data and we later test the proposed hypotheses. Table 2.1 gives an overview of the descriptive statistics for the variables used in this study. The first column shows the mean values for the entire sample, while

columns 2-7 show the standard deviation, the minimum, the maximum values and the quartile values for the firms in our sample. The total sample consists of 242 firms, 124 Spanish and 118 French firms, of which roughly 2/3 have controlled ownership and 1/3 dispersed ownership. The average audit fees for the entire sample are $5.9 million (median of €3.8 million). The highest fees in the sample are $72.92 million, while the smallest fees are $0.02 million. The average size of companies in our sample 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 a foreign market and the average leverage is 49 percent. Furthermore, firms operate in 3.13 different two-digit SIC industries segments and about 90% of all firms have at least one big4 auditor (Deloitte, Ernst & Young, KPMG or PwC). Furthermore, the results show the high degree of ownership concentration. For the entire sample, the average shareholdings by the largest shareholder are almost 40 percent and the shareholdings by the three largest is 52 percent. In terms of board composition, 77 percent of the board members are non-executives and 56 percent of the firms in our sample employ a single leadership structure.

The bivariate correlations between the variables considered in this study are presented in Table 2.2. The correlations between the audit fees and the independent variables show the expected sign. In line with previous literature, the highest correlation coefficient is found for firm size. Furthermore, the ownership concentration and single leadership are negatively correlated with audit fees, while board independence is not significantly correlated with the audit fees. The Variance Inflation Factor (VIF) considering the independent variables gives a mean value of 1.27 and a maximum value of 1.84 for Size, indicating that there are no multicollinearity problems.

Table 2.1: Descriptive statistics

The sample includes information for 124 Spanish and 118 French listed companies with respect to fiscal year 2007. Audit fees are the log transformation of the total amount of fees paid to all auditors for the audit services. Size is measured by the log transformation of the total assets. Foreign Sales is the percentage of foreign sales over total sales. Leverage is measured as the proportion of total long-term debt over total assets. Diversity of operations is measured by the number of different sectors the company operates in. Big 4 auditor is a dummy variable taking value 1 if at least one of the auditors is a Big-4 auditor(PwC, Ernst & Young, Deloitte and KPMG) and taking value 0 otherwise. Dispersed ownership is a dummy variable equal to one if the largest shareholder owns at least 20% of all shares and 0 otherwise. Board independence is measured by the number of non-executive board members over total board size. Single leadership is a dummy variable taking the value of 1 if the CEO is also the chairman and 0 otherwise.

	Mean	Std. Dev.	Min	Max	Quartile 1	Median	Quartile 3
Audit fees	15.59	2.16	7.96	18.11	13.02	15.16	16.81
Receivables and inventory scaled by total assets	0.36	0.19	0.00	0.96	0.21	0.35	0.48
Size	21.34	1.90	16.71	25.94	20.08	21.14	22.64
Foreign Sales	0.36	0.27	0.00	0.98	0.10	0.33	0.57
Leverage	0.49	0.50	0.05	1.00	0.53	0.64	0.77
Diversity of operations	3.13	1.65	1.00	8.00	2.00	3.00	4.00
Big-4 auditor	0.90	0.30	0.00	1.00	1.00	1.00	1.00
Ownership concentration	0.30	0.46	0.00	1.00	0.00	0.00	1.00
Stake held by the largest shareholder (SH1)	0.40	0.26	0.01	0.98	0.17	0.35	0.58
Stake held by the largest 3 shareholders (SH3)	0.52	0.24	0.01	0.98	0.32	0.54	0.68
Board Independence	0.77	0.12	0.25	1.00	0.66	0.78	0.86
Single leadership	0.56	0.50	0.00	1.00	0.00	1.00	1.00

Next, we discuss the multivariate analysis to tests the hypotheses. Table 2.3 presents the results obtained from regression model 1. The regression (1) measures the direct effect of the board characteristics, the ownership structure and the control variables on audit fees, for the entire sample. Consistent with previous literature, the control variables explain a large proportion of the audit fees variance. Firm size, foreign sales and the presence of Big-4 auditor(s) are associated with higher audit fees. The results from this first regression only provide support for our hypothesis 2 and 3, showing that firms with a single leadership structure and concentrated ownership have lower audit fees. Board independence shows a

positive, but insignificant, relationship with audit fees. Without considering the interaction between the ownership structure and the board composition, the results from regression (1) are only partially in line with findings in previous studies. For robustness purposes, the regressions (2) and (3) in Table 2.3 show the same analysis for each country separately. While for Spanish-listed firms, only single leadership is significantly related to audit fees, for the sample of French-listed firms, single leadership is significant at a 0.05 level and board independence at a 0.1 level. Overall, these results indicate that firms where the CEO also serves as the chairman of the board and firms with concentrated ownership have lower levels of audit fees, supporting our hypotheses 2 and 3.

Table 2.2: Correlation matrix

The sample includes information for Spanish and French listed companies with respect to fiscal year 2007. The total audit fees are the total amount of fees paid to all auditors for the audit services. Size is measured by total assets. Foreign Sales is the percentage of foreign sales over total sales. Leverage is measured as the proportion of total long-term debt over total assets. Diversity of operations is measured by the number of different sectors the company operates in. Big-4 auditor is a dummy variable taking value 1 if at least one of the auditors is a Big-4 auditor (PwC. Ernst & Young. Deloitte and KPMG) and taking value 0 otherwise. Dispersed ownership is a dummy variable equal to one if the largest shareholder owns at least 20% of all shares and 0 otherwise. Board independence is measured by the number of non-executive board members over total board size. Single leadership is a dummy variable taking the value of 1 if the CEO is also the chairman and 0 otherwise.

		1	2	3	4	5	6	7	8	9
1	Audit fees	1								
2	Receivables and inventory	0.04	1							
3	Size	0.75***	-0.08	1						
4	Foreign Sales	0.44***	0.02	0.31***	1					
5	Leverage	0.27***	0.08	0.43***	0.03	1				
6	Diversity of operations	0.36***	0.00	0.44***	0.14**	0.25***	1			
7	Big-4 auditor	0.27***	-0.10	0.29***	-0.04	0.05	0.15**	1		
8	Concentrated ownership	-0.21***	-0.03	-0.02	-0.10	0.12*	-0.01	-0.07	1	
9	Board Independence	0.02	-0.13*	-0.02	-0.04	0.02	-0.02	0.08	-0.08	1
10	Single leadership	-0.13**	-0.05	-0.09	-0.04	-0.05	-0.06	-0.17**	0.06	0.04

Significance level of 0.1: *; Significance level of 0.05: **; Significance level of 0.01: ***

Table 2.3: Regression results – Direct effects – full sample

Regressions are estimated as follows (equation 1):

Total audit fees = α + β_1 Receivables and inventory + β_2 Size+ β_3 Foreign Sales+ β_4 Leverage + β_5 Diversity of operations+ β_6 Big 4 auditor+ β_7 French firm + β_8 Ownership concentration + β_9 Board independence + β_{10} Single leadership + ε

The sample includes information for Spanish and French listed companies with respect to fiscal year 2007. The total audit fees are the amount of fees paid for the audit services. Receivable and inventory is measured as receivables plus inventory over total assets. Size is measured by total assets. Foreign Sales is calculated as foreign sales over total sales. Leverage is measured as the proportion of total long-term debt over total assets. Diversity of operations is measured by the number of different sectors the company operates in. Big-4 auditor is a dummy variable taking value 1 if at least one of the auditors is a Big-4 auditor and taking value 0 otherwise. French Firm takes value 1 if the firm is French and 0 if the firm is Spanish listed. Ownership concentration is a dummy variable taking value 1 if the largest shareholder owns at least 20% of all shares, and 0 otherwise. Board independence is measured by the number of non-executive board members over total board size. Single leadership is a dummy variable taking the value of 1 if the CEO is also the chairman and 0 otherwise.

	(1)	(2)	(3)
Receivables and Inventory	1.0811***	0.4745	1.0130*
	(0.3960)	(0.5369)	(0.5828)
Size	0.7129***	0.5521***	0.8961***
	(0.0559)	(0.0852)	(0.0722)
Foreign Sales	1.2543***	1.2294**	1.5094***
	(0.3247)	(0.5296)	(0.3784)
Leverage	-0.0767	-0.2008	0.2473
	(0.4910)	(0.6865)	(0.6422)
Diversity of operations	-0.0005	-0.1229	0.0747
	(0.0537)	(0.0830)	(0.0634)
Big 4 auditor	0.5385*	0.6939*	0.4677
	(0.2783)	(0.4192)	(0.3379)
French firm	0.9913***		
	(0.1868)		
Ownership concentration	-0.7290***	-0.7391***	-0.3066
	(0.1746)	(0.2731)	(0.2200)
Board independence	0.9585	0.9941	1.8064**
	(0.6663)	(1.0002)	(0.8950)
Single leadership	-0.5141**	-0.7336**	-0.3766*
	(0.1697)	(0.2531)	(0.2117)
intercept	-1.3155	2.4179	-5.8282***
	(1.1543)	(1.6766)	(1.6028)
N	242	124	118
Sub Sample		Spain	France
r2	0.6985	0.5258	0.7994
F	53.5208	14.0468	47.8282
p-value	0.0000	0.0001	0.0000

Standard errors in parentheses; * p<0.1; ** p<0.05; *** p<0.01

The main purpose of this study is to investigate whether shareholders with more power influence the behavior of the board of directors. Hypotheses 4 and 5 describe how boards in firms with ownership dispersion behave differently with respect to the demand for external audit compared to firms with ownership concentration. Table 2.4 presents the regression results for the entire sample, for each of the countries individually, and more importantly, for each type of ownership separately (concentrated or dispersed). For the sample of firms with concentrated ownership, i.e. where the largest shareholder owns at least 20 percent of all shares, we find no significant relationship between either board independence or single leadership and the audit fees (regression (4)). The results for the firms with dispersed ownership, on the other hand, are in line with the previous literature: there is a significant positive relationship between board independence and audit fees, and a significant negative relationship between single leadership and audit fees (regression (5)). Our results are consistent for both the Spanish (regressions (6) and (7)) and the French (regressions (8) and (9)) firms, where the relationship between the board characteristics and the audit fees is only significant for firms with dispersed ownership. Furthermore, our results show that the overall negative relationship between single leadership and audit fees (Table 2.3) is strongly driven by the subsample of firms with dispersed ownership. Overall, the results from table 2.4 show the importance of ownership structure on the behavior of the board with respect to audit fees.

Table 2.4: Regression results: by type of ownership

Regressions are estimated as follows (equation 5):

Total audit fees = α + β_1 Receivables and inventory + β_2 Size+ β_3 Foreign Sales+ β_4 Leverage + β_5 Diversity of operations+ β_6 Big 4 auditor+ β_7 French firm + β_8 Board independence + β_9 Single leadership + ε

The total audit fees are the amount of fees paid for the audit services. Receivable and inventory is measured as receivables plus inventory over total assets. Size is measured by total assets. Foreign Sales is calculated as foreign sales over total sales. Leverage is measured as the proportion of total long-term debt over total assets. Diversity of operations is measured by the number of different sectors the company operates in. Big 4 auditor is a dummy variable taking value 1 if at least one of the auditors is a Big-4 auditor and taking value 0 otherwise. French Firm takes value 1 if the firm is French and 0 if the firm is Spanish listed. Board independence is measured by the number of non-executive board members over total board size. Single leadership is a dummy variable taking the value of 1 if the CEO is also the chairman and 0 otherwise. Firms where the largest shareholder owns at least 20% of all shares are defined as firms with concentrated ownership, and as firms with dispersed ownership otherwise.

	(4)	(5)	(6)	(7)	(8)	(9)
Receivables and Inventory	0.4935	1.8318**	-0.2441	2.0125	0.4016	1.5102
	(0.4369)	(0.8103)	(0.5799)	(1.3019)	(0.7031)	(0.9511)
Size	0.7241***	0.5993***	0.5913***	0.4570**	0.8559***	0.6196***
	(0.0650)	(0.1011)	(0.0957)	(0.1737)	(0.0894)	(0.1295)
Foreign Sales	1.5921***	0.2210	0.6875	1.6566	2.0840***	0.2191
	(0.3732)	(0.5554)	(0.5846)	(1.1776)	(0.4869)	(0.5326)
Leverage	-0.1607	0.4433	0.2031	0.0586	-0.0588	0.7072
	(0.5608)	(0.8784)	(0.7666)	(1.5403)	(0.7876)	(0.8938)
Diversity of operations	0.0093	-0.0081	-0.0992	-0.3006	0.0640	0.1183
	(0.0607)	(0.0963)	(0.0885)	(0.1895)	(0.0775)	(0.0908)
Big-4 auditor	0.5360*	0.2663	0.5641	0.7944	0.5821	1.1966
	(0.3021)	(0.5780)	(0.4850)	(0.8613)	(0.3625)	(1.0607)
French firm	0.8717***	1.8984***				
	(0.2019)	(0.4225)				
Board independence	-0.8620	5.4395***	-1.2142	7.2197***	0.4910	3.4214**
	(0.7519)	(1.2435)	(1.0732)	(2.2808)	(1.1154)	(1.3326)
Single leadership	-0.1418	-1.5524***	-0.3980	-1.4576**	0.0397	-1.6345***
	(0.1941)	(0.3173)	(0.2779)	(0.5524)	(0.2711)	(0.3380)
intercept	-0.9333	-2.2081	2.5338	-0.8797	-4.4937**	-0.6885
	(1.3181)	(2.0554)	(1.9373)	(3.3210)	(1.9456)	(2.7645)
N	170	72	88	36	82	36
Sub Sample	Concentrated	Dispersed	Spain - Concentrated	Spain - Dispersed	France - Concentrated	France - Dispersed
r2	0.6780	0.8119	0.5423	0.6655	0.7700	0.9073
F	37.4253	29.7269	11.7021	6.7136	30.5412	33.0422
p-value	0.0000	0.0000	0.0005	0.0043	0.0000	0.0000

Standard errors in parentheses; * p<0.1; ** p<0.05; *** p<0.01

Finally, we test hypotheses 4 and 5 using regression model II. The results from Table 2.4 show that the relationship between board characteristics and audit fees is contingent on the ownership structure. Using interaction terms, we are able to test whether the relationship between the board characteristics and audit fees is significantly different between the types of ownership of the company. Table 2.5 displays the results of regression model II for different specifications of ownership concentration. Regression (10) measures the importance of the moderation effect of ownership concentration on the relationship between board characteristics and audit fees. The analysis provides support for the hypotheses 4 and 5 that the relationship between board characteristics and external audit demand is contingent on the concentration of ownership. Specifically, the results show that the relationship between board independence and audit fees as well as the relationship between single leadership and audit fees is significantly different for firms with concentrated ownership in comparison to firms with dispersed ownership. To test the robustness of our results, we repeat the analysis for different specifications of ownership concentration. We first use two alternative thresholds to categorize ownership concentration. Regression (11) defines ownership concentration as a firm where the largest shareholder owns at least a 25 percent of all shares, while regression (12) adopts a 30 percent threshold. Furthermore, we use two continuous variables to measure ownership concentration. Regression (13) uses the total shareholdings by the largest shareholder to capture ownership concentration while regression (14) uses the total shareholdings by the three largest shareholders. For all alternative specifications, the main results hold. Overall, the results support hypotheses 4 and 5 by showing that ownership concentration significantly influences the relationship between board independence and audit fees, on the one hand, and between single leadership and audit fees, on the other hand.

Table 2.5: Regression results – Interaction effects – full sample

Regressions are estimated as follows (equation 11-15):

*Total audit fees = α + β_1 Receivables and inventory + β_2 Size+ β_3 Foreign Sales+ β_4 Leverage + β_5 Diversity of operations+ β_6 Big 4 auditor+ β_7 French firm + β_8 Ownership concentration + β_9 Board independence + β_{10} Single leadership + β_{11} Ownership concentration*Board independence + β_{12} Ownership concentration*Single leadership + ε*

The total audit fees are the amount of fees paid for the audit services. Receivable and inventory is measured as receivables plus inventory over total assets. Size is measured by total assets. Foreign Sales is calculated as foreign sales over total sales. Leverage is measured as the proportion of total long-term debt over total assets. Diversity of operations is measured by the number of different sectors the company operates in. Big-4 auditor is a dummy variable taking value 1 if at least one of the auditors is a Big-4 auditor and taking value 0 otherwise. French Firm takes value 1 if the firm is French and 0 if the firm is Spanish listed. Board independence is measured by the number of non-executive board members over total board size. Single leadership is a dummy variable taking the value of 1 if the CEO is also the chairman and 0 otherwise. Five different specifications are used to measure ownership concentration. Equations 11-13 define ownership concentration as a dummy variable, using thresholds of 20%, 25% and 30% respectively. Equations 14 and 15 adopt a continuous measure using the total shareholdings by the largest (SH1) and 3 largest shareholders (SH3).

	(10)	(11)	(12)	(13)	(14)
†Ownership concentration	SH1<20%	SH1<25%	SH1<30%	SH1	SH3
Receivables and Inventory	0.7564**	0.9904**	1.0643**	0.8889**	0.9987**
	(0.3825)	(0.3953)	(0.3891)	(0.3974)	(0.3913)
Size	0.7075***	0.7020***	0.7080***	0.6971***	0.7067***
	(0.0539)	(0.0561)	(0.0555)	(0.0560)	(0.0560)
Foreign Sales	1.2425***	1.2584***	1.1813***	1.1768***	1.1394***
	(0.3089)	(0.3229)	(0.3197)	(0.3227)	(0.3202)
Leverage	-0.0695	-0.1923	-0.2298	-0.0798	-0.1432
	(0.4680)	(0.4872)	(0.4810)	(0.4895)	(0.4857)
Diversity of operations	0.0196	0.0067	0.0026	0.0078	0.0085
	(0.0512)	(0.0535)	(0.0529)	(0.0532)	(0.0528)
Big 4 auditor(s)	0.5521**	0.6619**	0.5989**	0.5508**	0.5480**
	(0.2651)	(0.2772)	(0.2730)	(0.2776)	(0.2753)
French firm	1.0365***	1.1004***	1.1208***	1.1160***	1.1068***
	(0.1784)	(0.1881)	(0.1852)	(0.1878)	(0.1854)
†Ownership concentration	2.8262***	2.0495**	2.0589**	3.9894*	4.6754**
	(1.0635)	(1.0414)	(0.9916)	(2.0586)	(2.2604)
Board independence	4.7015***	3.3109***	3.0202***	3.9824***	5.5773***
	(1.1497)	(1.0713)	(0.9330)	(1.2075)	(1.5996)
Single leadership	-1.3095***	-0.8809***	-0.8328***	-1.1076***	-1.2934***
	(0.2825)	(0.2568)	(0.2427)	(0.2927)	(0.3754)
†Ownership concentration * Board independence	-5.3685***	-3.7809***	-3.9268***	-7.4225***	-8.6643***
	(1.3437)	(1.3229)	(1.2625)	(2.5938)	(2.8491)
†Ownership concentration * Single leadership	1.1237***	0.5938*	0.5666*	1.3677**	1.4630**
	(0.3331)	(0.3257)	(0.3170)	(0.6105)	(0.6499)
intercept	-3.6896***	-2.9847**	-3.7783**	-3.1061**	-4.1781**
	(1.4024)	(1.3886)	(1.3086)	(1.4339)	(1.7187)
N	242	242	242	242	242
r2	0.7296	0.7046	0.7123	0.7073	0.7126
F	51.4831	45.5222	47.2476	46.1089	47.3276
p-value	0.0000	0.0000	0.0000	0.0000	0.0000

Standard errors in parentheses; * p<0.1; ** p<0.05; *** p<0.01

2.5 Conclusions and limitations

The aim of this paper is to offer greater insight into how corporate governance mechanisms are contingent on the ownership structure of the firm. We argue that the ownership structure influences the behavior of the board of directors. Boards in firms with dispersed ownership, with a strong focus on control, are more likely to favor a higher demand of audit services relative to boards in firms with ownership concentration, where independent board members contribute with the provision of resources to the management. To assess our arguments, we examine the relationship between board characteristics and the demand for external audit in firm with dispersed and concentrated ownership. The results show that the influence of board independence and single leadership on the external audit demand is contingent on the concentration of ownership. For firms with dispersed ownership, we find that both board independence and single leadership are significantly related to the total audit fees. This is in line with previous literature which typically considers large US or UK companies. In contrast, for firms with concentrated ownership, the relationship between board characteristics and the demand for external audit is insignificant. These results are consistent with the argument that the ownership structure has an important influence on the board behavior. Finally, the study shows that even in countries without a high risk of lawsuits against board members, outside board members demand for more audit, indicating that the higher demand for audit by outside board members is not only driven by the fear of facing a lawsuit.

Our results complement the existing research conducted in the context of dispersed firms and highlight the importance of considering ownership structure patterns for policymakers, since a similar degree of board independence may lead to a different behavior contingent on the ownership structure of the firm. For future research, it may be interesting to look at the interaction between ownership and other corporate governance practices.

Ownership control may have a similar influence on voluntary disclosure, compliance with corporate governance codes or the adoption of risk management practices. Finally, our findings suggest that firms with dispersed ownership in a different corporate environment behave similar to UK/US firms. It may, therefore, be interesting to explore in the future whether the reverse would also hold. Do firms with concentrated ownership in the US/UK behave similarly to firms with concentrated ownership in Continental Europe?

Our study has several limitations. First it focuses on listed companies with a single board structure. It is therefore possible that the results may not be generalized 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. Finally, previous literature has also studied the relationship between audit committees and external audit, in addition to the board composition. Although audit committees were practically non-existent prior to the early/mid 1990s in Continental Europe, they have been adopted as part of the corporate governance structure within companies as a result of national and international regulatory pressures (Collier land Zaman 2005). However, audit committees for listed companies were only obligatory as of 2003 in Spain, while their creation remains a voluntary decision in France as no explicit regulation exists on audit committees (except for financial institutions). The role of the specialized committees is to facilitate the work of the board of directors and help with effective preparation of decisions. These committees should not siphon off the board's power, and their role is therefore purely consultative. Given the limited importance of the audit committee in both France and Spain, we study the actions of the board of directors rather than restricting the scope of our investigation to the audit committee.

To conclude, our study shows that some corporate governance mechanisms to run firms effectively hold across corporate governance systems but that it is important to understand what makes firms different within governance systems. We have shown that patterns of ownership are an important characteristic to take into account.

Chapter 3

Ownership structure and stock price performance during plummeting and soaring financial markets

3.1 Introduction

The notion of diffuse stock ownership is well entrenched among economists. The debate was initiated by Adam Smith's legendary warning in *Wealth of Nations* about the "negligence and profusion" that will result when those who manage enterprises are "rather of other people's money than of their own." A century and a half later, the arguments of Berle and Means (1932) on the dangers of diffuse stock ownership, written during the Great Depression, helped to shape the federal securities legislation of the 1930s (Holderness, 2003). That legislation was intended to protect diffuse shareholders from professional managers. In nearly 200 years of recorded stock-market history, no calendar decade has seen such a dismal performance as the 2000s. Stock markets worldwide have experienced severe shocks, causing extreme losses and gains in very short periods of time. For example, as a result of the internet bubble bursting, the S&P500 lost 15 percent over the period of 10 days in July 2002, while other mayor stock market indexes suffered similar losses (FTSE-100: 15 percent; DAX-30: 17 percent; CAC-40: 18 percent) over the same 10-day period. This study looks at extreme up and down market periods over the last decade to understand how minority shareholders value the ownership structure of firms during periods of market turmoil.

The ownership structure is one of the main dimensions of corporate governance and is significantly different across countries, with dispersed ownership being much more frequent in US and UK listed firms, compared to Continental Europe, where controlled ownership is prevalent (La Porta et al., 1999). Faccio and Lang (2002) report in a study of 5232 publicly traded corporations in 13 Western European countries that only 36.93 percent were firms with dispersed ownership. In addition, La Porta et al. (1999) point out that ownership of large companies in rich economies is typically concentrated, that control is often exercised through pyramidal groups with a holding company at the top controlling one or more subsidiaries and that the controlling shareholders are often actively involved in company management and sit on the board of directors. We refer to Enriques and Volpin (2007) for a detailed description of the differences in the ownership structure of companies in the main economies of continental Europe with comparisons to the UK and US.

Large block ownership can be motivated by two factors: the shared benefits of control and the private benefits of control. The shared benefits of control arise from the superior management or monitoring that can result from the substantial collocation of decision rights and wealth effects that come with large-block ownership. As the ownership stake of a blockholder increases, ceteris paribus, the incentives to increase firm value increase. To the extent that these higher cash flows are shared with minority shareholders, they constitute shared benefits of control. However, blockholders also have the incentive to use their voting power to consume corporate resources or to enjoy corporate benefits that are not shared with minority shareholders. These are the private benefits of control. Such benefits could either be pecuniary, such as excess salary for an individual blockholder or synergies in production for a corporate blockholder, or they could be non-pecuniary, such as the amenities that apparently come from controlling corporations like professional sports teams and newspapers. Since

ownership control can have both positive and negative properties, empirical evidence is crucial to understand the value of ownership concentration.

The objective of this study is to investigate the valuation of the ownership structure by minority shareholders during plummeting and soaring financial markets in a Continental-European setting. To obtain greater insight into the valuation of the ownership structure from a minority shareholders perspective, it is crucial to have a sample with sufficient diversity in terms of the ownership structure, a condition fulfilled in most continental Europe stock markets. Continental European firms adopt a wide variety of ownership structures, going from firms with only small diffuse shareholders to firms with majority shareholders. In addition, a European context also allows studying the importance of secondary blockholders as well as the importance of different types of the controlling owner on stock price performance.

Previous literature has extensively focused on the relationship between ownership structure and financial and market performance. However, far less attention has been paid to the valuation of the ownership structure by minority shareholders. Dyck and Zingales (2004) argue that the potential extraction of private benefits by controlling shareholders reduces what minority shareholders are willing to pay for shares, lowering the value of all companies where such behavior represents a real possibility. A common critique of the ownership-performance literature is that corporate ownership is an endogenous variable rather than an exogenous influence on firm profitability (Demsetz and Lehn, 1985). In the words of Demsetz and Villalonga (2001: 210): “the ownership structure of a corporation should be thought of as an endogenous outcome of decisions that reflect the influence of shareholders and of trading on the market for shares”. As an equilibrium outcome, the effect of ownership on performance is likely to be null (Demsetz and Villalonga, 2001). However, the validity of this argument

strongly depends on the liquidity and transaction costs of the underlying stock market. Ownership is likely to be endogenous when shareholders have sufficient information about the future performance variability of the companies in which they invest, and when they can adjust the size of their shareholdings at no cost. Ownership in Continental European firms is relatively stable, in part because the restructuring of ownership is costly and difficult since the stock market is less developed. In these markets ownership can be treated as an exogenous variable, as investors can neither acquire nor divest controlling blocks without incurring significant costs, and must therefore seek to maximize the performance of corporations given the block of shares they own in them (Stiglitz, 1994). In other words, the Continental European context allows us to sidestep the endogeneity critique of the ownership literature.

Since ownership control can be both positive and negative consequences for the firm performance and shareholder valuation, empirical evidence is of paramount importance for judging about its final effect and for orienting regulations that could hamper the persistence of large controlling shareholders. Our results show the importance of ownership concentration, the presence of secondary blockholders and the type of the controlling owner to explain stock price performance. In addition, the analysis shows that the results for extreme down markets are fundamentally different from the results for the up market. While ownership concentration is valued positively during down market periods, it is valued negatively during up market periods. This study builds on prior research in several ways. First, unlike most existing research, which usually studies just one aspect of ownership structure, we focus on several dimensions of the ownership structure: ownership concentration, multiple blockholders and type of the controlling owner. Second, rather than focusing on periods of market crisis, we analyze the stock price performance during extreme down market periods as well as extreme up market periods. Combining both perspectives provides insight into how minority

shareholders valuation changes during periods of extreme market turmoil. Our results seem to indicate that ownership concentration is associated with more stable stock valuation during periods of market turmoil; especially firms controlled by a financial institution tend to lose less value during down markets and gain less value during up markets. Third, this is one of the first papers to investigate the importance of ownership structure from a minority investor's perspective using data from a Continental European stock market. In contrast to most previous studies, our data set allows to calculate the ownership structure prior to the periods of interest and to control for stock price movements caused by movements by large blockholders during the period of market turmoil. The results also add to the convergence argument of corporate governance systems that cross-national patterns of corporate governance are converging or will converge on the Anglo-Saxon, capital-market driven model characterized by a sharp separation between ownership and control as this model more efficient than alternative models such as those underpinning family firms, conglomerates, bank-led groups or worker cooperatives. The findings of this study indicate that the minority shareholders attach a positive value to ownership concentration, especially if the controlling owner is a financial institution, in periods of extreme down markets. Furthermore, the results seem to indicate that during periods of extreme market turmoil, firms with dispersed ownership are significantly more sensitive to the stock market environment than firms with large controlling shareholders. The results of the study also have implications for policy makers, by showing that firms with concentrated ownership are less subjective to extreme market periods. To the extent that ownership concentration might contribute to the financial and economic stability of listed firms during periods of market turmoil, this study provides empirical insights against regulations that could hamper the persistence of large controlling shareholders.

3.2 Prior literature and hypotheses development

Shareholder structures are quite diverse across countries, with dispersed ownership being much more frequent in US and UK listed firms, compared to Continental Europe, where controlled ownership is prevalent (La Porta, et al., 1999). An important weakness of dispersed ownership is that dispersed owners lack both the means and the motive to address managerial agency problems. In the presence of information asymmetry and interest misalignment between the owner/ principal and the manager/agent, problems associated with managerial opportunism are important (Fama and Jensen, 1983; Jensen and Meckling, 1976). Berle and Means (1932) suggest that ownership concentration could have a positive effect on firm value because it alleviates the conflict of interests between owners and managers. Ownership concentration mitigates this conflict by bringing about greater alignment of incentives (if ownership is concentrated in the hands of managers themselves) or improved monitoring (if it is concentrated in the hands of outside shareholders.

In a company with a large shareholder and a fringe of small shareholders (as modeled by Shleifer and Vishny, 1986), the classic owner-manager conflict (i.e. agency problem I) is mitigated due to the large shareholder's greater incentives to monitor the manager. However, a second type of conflict appears (i.e. agency problem II) as the large shareholder may use its controlling position in the firm to extract private benefits at the expense of the small shareholders. The empirical corporate governance literature offers no unequivocal answer to the costs and benefits of concentrated ownership. Some scholars have found a positive association with corporate performance (La Porta et al., 2000), others a negative association (Loderer and Martin, 1997), and still others a curvilinear relationship (Morck, Shleifer, and Vishny, 1988), and Demsetz and Lehn (1985), Himmelberg et al. (1999), and Demsetz and Villalonga (2001) provide evidence in support of Demsetz (1983)'s arguments of no difference. Theoretically compelling arguments can be furnished in favor of each finding.

Although previous studies (e.g. Johnson et al., 2000; La porta et al., 2000) have used cross-country analysis to demonstrate the importance of corporate governance characteristics in determining firm value, few researchers have investigated the relevance of ownership concentration for minority investors during periods of stock market turmoil. From a theoretical point of view, the relationship between stock price performance and ownership concentration during periods of turmoil could be both positive and negative. On the positive side, having a large controlling shareholder can help firms in times of crisis as such owners sometimes choose to transfer private resources into an ailing firm. This phenomenon, also known as "propping," can help firms survive a temporary slump in performance, when owners choose "to invest private cash today in order to preserve their options to expropriate and to obtain a legitimate share of profits tomorrow" (Friedman, Johnson, and Mitton, 2003: 734). On the other hand, during periods of financial crisis, controlling shareholders have a larger incentive to transfers assets and profits out of better-performing firms towards their underperforming affiliates to "bail them out" (Gedajlovic and Shapiro, 2002; Granovetter, 2005). In addition to the increased incentives for expropriation, a change in the perception on the liquidity of the shares during periods of stock market turmoil could influence the relationship between the ownership structure and stock price performance. Vayanos (2004) argues that the preference for liquidity widens dramatically during extreme market episodes. A term often used to characterize these episodes is flight to liquidity, suggestive of the notion that investors experience a sudden and strong preference for holding liquid assets. Firms with high ownership concentration have less free float and are less liquid compared to similar firms with dispersed ownership. Therefore, one could expect that, as a result of a flight to liquidity during periods of market turmoil, firms with dispersed ownership have a higher stock price performance compared to firms with concentrated ownership.

A few studies have examined the link between corporate governance and firm value during periods of economic crisis. Using data for public companies in East Asia, Claessens et al. (2002) find that firm market value increases with the cash-flow ownership of largest shareholders, but drops when the control rights of largest shareholders exceed their cash-flow ownership. Similar results are found in Korea (Joh, 2003; Baek et al., 2004). Furthermore, Mitton (2002) shows a significant relationship between corporate governance mechanisms and stock price performance during the Asian crisis of 1997–1998 for a sample of firms from five East Asian countries. He argues that corporate governance becomes more critical in explaining cross-firm differences in performance during a financial crisis because of the increased incentive for expropriation of minority shareholders as well as the greater investor awareness of weaknesses in corporate governance in the region which could lead them to pull-out (Rajan and Zingales, 1998). Consistent with these arguments, Mitton (2002) finds that firms with higher outside ownership concentration experienced better stock price performance during the crisis. Considering the arguments in favor and against ownership concentration as well as previous findings, we suggest that:

H1a: There is a positive relationship between ownership concentration and the stock price performance during periods of turmoil.

There is some evidence suggesting that that the effects of ownership structure on performance are non-monotonic (Demsetz and Villalonga, 2001; Morck et al., 1988; McConnell and Servaes, 1990), and that they vary with the size of the concentrated owner's stake. When a concentrated owner's stake is relatively low, the owner has insufficient control to successfully engage in tunneling or other minority-disadvantaging strategies. Under these

conditions, the concentrated owner's most effective strategy for increasing his or her private wealth is to push the management of the firm for greater performance. Hence relatively low levels of concentrated ownership will have an overall positive influence on corporate performance. At higher levels of ownership, however, a point will be reached where the concentrated owner effectively controls the firm, while there is still a significant fraction of small investors to expropriate. Under these conditions tunneling is both feasible and lucrative, and the effect of concentrated ownership on corporate performance will cease to be positive. Since in many jurisdictions dominant shareholders can have control rights in excess of their ownership rights (La Porta et al., 1999), tunneling often becomes a real possibility. However, as the concentrated ownership stake increases further, tunneling becomes a less sensible strategy for increasing private wealth, as there will be fewer minority shareholders to expropriate. Tunneling would then simply result in a direct transfer of private wealth from one venture into another, which is unlikely to benefit the concentrated owner. As the best strategy for majority owners to increase their private wealth is to gear the firm for higher performance, very large ownership stakes are again likely to have a positive effect on firm performance (and minority shareholder valuation). Previous research by Morck et al. (1988) has reported a non-monotonic relationship between the degree of ownership concentration and firm profitability. In addition, Gedajlovic and Shapiro (1998) show evidence of a non-linear relationship between ownership concentration and profitability in US and German firms. Nevertheless, no relationship between concentration and profitability was found in the UK, France and Canada. Kaplan and Minton (1994) and Gorton and Schmid (2000), on the other hand, found a linear relationship for a sample of Japanese and German firms respectively. For a sample of Spanish listed companies, De Miguel et al. (2004) find that ownership concentration has a nonlinear effect on firms' value. Given the theoretical arguments and

previous empirical findings, we test for quadratic and cubic relationship between ownership concentration and stock price performance:

H1b: The relationship between ownership concentration and stock price performance follows a non-monotonic pattern during periods of turmoil.

With the exception of Laeven and Levine (2007) and Maury and Pajuste (2005), most of the empirical studies focus little, if any, attention on the role of multiple blockholders in corporate governance. Blockholders are defined as shareholders who own at least 5 percent of a company's common shares. Arguably, the neglect of the potential monitoring benefits of blockholders, beyond the largest controlling shareholder, reflects the assumption that the former represent a homogenous group of uninvolved stakeholders, with weak incentives and little power to engage in monitoring activities. However, La Porta et al. (1999), Claessens et al. (2000) and Faccio and Lang (2002) all document numerous instances of multiple large blockholders across the globe.

Only very recently have a few theoretical papers started to study how controlling groups are formed when there are multiple large shareholders (Zwiebel, 1995; Bennedsen and Wolfenzon, 2000) and what is are the effect of multiple blockholders on monitoring (Pagano and Röell, 1998) and on the level of private benefit extraction (Bennedsen and Wolfenzon, 2000). Minority shareholders could associate the presence of multiple blockholders with efficient monitoring because large shareholders can bring valuable internal monitoring either by forming coalitions with large equity stakes or by competing for corporate control (Bennedsen and Wolfenzon, 2000). Alternatively, multiple blockholders can present an opportunistic structure for coercive voting, where blockholders would find it mutually

valuable to collude to extract divisible private benefits of control (e.g., Winton, 1993; Zwiebel, 1995; Kahn and Winton, 1998). These divergent perspectives imply that whether or not multiple blockholders serve a monitoring role in mitigating the agency problems that beset concentrated control remains an empirical question.

Empirical evidence validating the theoretical predictions is very limited. Volpin (2002) finds that the market value of Italian listed firms is higher for companies with a voting syndicate than for companies with a single large shareholder. Faccio et al. (2001) compare the dividend policies of listed companies across different countries and find that European companies pay higher dividends when they have multiple blockholders. Lehman and Weigand (2000) show that the presence of a second large shareholder improves the profitability of German listed companies. In light of previous finding, we argue that:

H2a There is a positive relationship between shareholdings by secondary blockholders and minority shareholder performance during periods of turmoil.
H2b: There is a positive relationship between the number of blockholders and minority shareholder performance during periods of turmoil.

The classic owner-manager conflict is mitigated in the presence of large controlling shareholders. However, a second type of conflict appears as controlling owners may use their controlling position in the firm to extract private benefits at the expense of the small shareholders. The importance of the conflict between large controlling shareholders and minority shareholders could depend on the identity of the controlling owner. Different preferences and priorities with respect to corporate risk, stability, growth, and performance may exist for different types of controlling owners (Douma et al., 2006; Gedajlovic et al.,

2005). If it concerns a financial institution, such as a bank or an investment fund, the private benefits of control are diluted among several independent owners. If the large shareholder is an individual, a family or a non-financial firm, it has greater incentives for both expropriation and monitoring, which could lead agency problem II to overshadow agency problem I (Villalonga and Amit, 2006). We identify 3 different types of controlling owners: Family control, control by a financial institution and control by a non-financial firm.

Families may use their control over companies to extract private benefits of control at the expense of minority shareholders. The private benefit extraction may take different forms such as excessive compensation of family members or related-party transactions. In addition, families may be excessively interested in maintaining control over the company even in the presence of a potentially value increasing acquirer. When the family owns less than 100 percent of the shares of the company, it gives an excessive weight to private benefits of control over security benefits. Another type of cost of family ownership has to do with the family itself and the ties among its members. Family owners may have the incentive and power to assign key management positions to family members even when there are unqualified (Claessens et al., 2000). More generally, family priorities may conflict with the objectives of outside investors. Family control does not only come with cost, though. Families may have longer investment horizon with respect to other shareholders thereby avoiding managerial myopia. Because the company will be controlled by future generations of the family, family firms may be natural long term value maximizers.

Since family control can have both positive and negative properties, empirical evidence is of paramount importance for judging about its final effect and for orienting regulations that could hamper the persistence of family controlled firms. Recently, several

papers have begun to analyze the performance of family firms. Denis and Denis (1994) study majority-owned firms, and find that, although most of them are characterized by family involvement, they do not exhibit specific inefficiency features. Based on data from S&P 500 firms, Anderson and Reeb (2003) find that family firms perform better than non-family. However, Morck et al. (2000), using Canadian data, provide evidence that family control deteriorates firm performance, as firms with dispersed ownership have a superior performance with respect to family firms. In addition they find no evidence of a longer horizon in decision making in family firms, as they invest less in R&D and have fewer employees than widely held firms. Furthermore, Faccio, Lang and Young (2001) report that family ownership in East Asia leads to severe conflicts with other claimants and hampers firm performance. Their results are supported by Baek et al. (2004) who find that Korean chaebol firms with concentrated ownership by controlling family shareholders experienced a larger drop in the value of their equity during the Korean crisis. As far as Western Europe is concerned, two cross-country studies by Barontini and Caprio (2006) and Maury (2006) using panel data observe that family firms may have a higher market valuation calculated as Tobin's Q and a higher profitability under certain conditions. Barontini and Caprio find similarities to the study by Anderson and Reeb (2003) confirming that especially family firms with founder CEO perform better than other firms. Evidence on single European countries shows similar findings. Family firms outperform others depending on their characteristics. Both Favero et al. (2006) in their study of Italian listed family firms, Sraer and Thesmar (2007) on French listed family firms and Galve-Górriz and Salas-Fumás (2005) on Spanish listed firms report that family firms outperform companies with dispersed ownership. In a study on German listed firms Andres (2008) finds that family firms are not only more profitable than firms with dispersed ownership but also than companies with other kinds of blockholders. In line with previous research in Europe, we argue that:

H3: There is a positive relationship between family control and stock price performance during periods of turmoil.

Researchers have tested the monitoring effect of both institutional investors and blockholders in a variety of settings. Early research studies partitioned large owners into financial and non-financial classifications and concluded that financial investors were better monitors than non-financial shareholders when measuring their effect on firm value (McConnell and Servaes, 1990) and risk taking (Wright et al., 1996). Financial institutions tend to have multiple ties with the firms in which they own shares and their equity stake primarily serves to cement an often complex set of non-shareholder relationships with the focal firm (Roe, 1994). Lehmann and Weigand (2000) confirm the benefits of large shareholders in Germany only in the case of banks, since the presence of non-financial large owners negatively affects firm profitability.

During periods of financial crisis, controlling shareholders have a larger incentive to transfers assets and profits out of better-performing firms towards their underperforming affiliates (Gedajlovic and Shapiro, 2002; Granovetter, 2005). This concern is less important for financial institutions as they have a large and diversified investment portfolio which reduces the incentive to use the control to transfer wealth as the impact will be relatively small. In addition, since financial institutions typically have no controlling owners, the benefits of expropriation would be shared between several independent owners. Therefore we expect the minority shareholders to value firms controlled by a financial institution higher compared to firms controlled by a non-financial firm:

H4: There is a positive relationship between financial institutions 'control and stock performance during periods of turmoil.

H5: There is a negative relationship between non-financial firm control and stock performance during periods of turmoil.

3.3 Sample and data

Our sample is drawn from the population of Spanish firms listed on the Madrid Stock Exchange during January 2000- January 2008. Fundamental stakeholders in the Spanish corporations include banks and industrial firms, although the role of financial institutions is not as prevalent as in other countries such as Germany and Japan, and the main agency problem arises from controlling and minority shareholders, as occurs in most European countries. For this study, we consider all listed firms (both financial and non-financial) for which we could retrieve the stock price and the ownership structure data. For the period January 2000- January 2008, we calculated the daily 10, 20 and 30 trading day performance of the Ibex-35 (the Spanish reference stock exchange market index). We then identified the ten largest jumps and plummets for each time frame, avoiding overlap of periods within each timeframe. Table 3.1 gives an overview of the starting dates for each time frame, as well as the IBEX-35 stock price performance. After identifying the periods of maximum stock market turmoil, we calculated the individual stock price performance for each listed company. Obviously, the sample of listed companies varies slightly across time, as some companies start listing on the stock market while others de-list during the 2000-2008 period considered in this study.

Table 3.1: Descriptive statistics – stock price performance of the IBEX-35 over the selected down and up market periods considering a 10, 20 and 30 days trading window

Down	10 day trading window			20 day trading window			30 day trading window		
Periods	Date	Return	N	Date	Return	N	Date	Return	N
1	10/3/2000	-10.8%	95	5/2/2000	-10.3%	94	3/6/2000	-12.5%	89
2	11/8/2000	-11.8%	96	11/6/2000	-14.5%	97	9/5/2000	-10.1%	92
3	3/8/2001	-12.9%	92	6/14/2001	-13.8%	97	11/6/2000	-16.5%	96
4	9/6/2001	-17.8%	89	8/23/2001	-22.7%	93	2/8/2001	-14.9%	93
5	6/10/2002	-11.1%	95	5/29/2002	-15.9%	93	5/31/2001	-14.0%	98
6	7/8/2002	-12.4%	93	7/8/2002	-16.4%	93	8/8/2001	-23.0%	91
7	9/11/2002	-16.1%	93	8/27/2002	-19.6%	94	6/12/2002	-18.7%	95
8	1/14/2003	-9.6%	93	1/16/2003	-12.0%	96	8/27/2002	-18.6%	93
9	5/8/2006	-9.3%	113	2/14/2007	-8.7%	120	1/15/2003	-12.0%	97
10	1/9/2008	-16.1%	132	12/19/2007	-19.3%	135	12/5/2007	-22.5%	131
Up	10 day trading window			20 day trading window			30 day trading window		
Periods	Date	Return	N	Date	Return	N	Date	Return	N
1	1/31/2000	15.0%	92	1/28/2000	15.3%	90	12/18/2000	11.8%	92
2	3/22/2001	9.5%	94	12/20/2000	13.0%	95	3/22/2001	13.2%	94
3	9/20/2001	11.0%	94	9/21/2001	19.7%	93	9/21/2001	22.0%	97
4	10/9/2001	11.2%	92	10/30/2001	11.6%	96	10/9/2002	21.1%	94
5	11/2/2001	11.2%	92	7/24/2002	11.2%	94	3/12/2003	19.1%	96
6	10/10/2002	11.1%	91	10/7/2002	16.6%	90	5/9/2003	10.9%	96
7	11/13/2002	9.2%	95	3/12/2003	18.6%	97	11/18/2003	11.5%	100
8	12/30/2002	9.5%	90	5/21/2003	13.2%	103	1/18/2006	11.2%	113
9	3/12/2003	12.7%	95	3/14/2007	10.0%	121	9/11/2006	13.0%	118
10	3/31/2003	10.5%	101	9/17/2007	10.9%	128	9/17/2007	14.9%	129

The principal source of our ownership structure data is the database from the CNMV (Spanish Securities and Exchange Commission, the equivalent to the U.S. Securities and Exchange Commission). Under the Spanish Companies law, listed companies are obliged to report to the CNMV the names and shareholdings of shareholders with blocks of shares of 5 percent or more and any holdings for those that seat in the board of directors. This requirement became active through the Spanish transposition of the European transparency directive (Council Directive of 12 December 1988 (88/627/EEC)). From these files of the CNMV, we analyzed a total of 24.786 communications to determine the ownership structure for any given date as well as all changes in the ownership structure between any two dates. To

calculate the ownership measures, we consider both direct and indirect shareholding. The ownership data is determined for the first day of the turmoil period. We also calculate the changes in the ownership structure during the considered up or down market periods. In addition, for each firm we identified the family ties between different shareholders using the company website, annual reports, and other public sources of information.

Spanish listed companies have a number of characteristics that make them particularly suited to our investigation, as it presents corporate governance characteristics similar to many other Continental European countries, but quite different from Anglo-American or Asian listed companies. Continental European countries are typically categorized by concentrated ownership of firms, strong state intervention, and weak labor participation at company level (Rhodes and Van Apeldorn 1997; Aguilera and Jackson 2003). As noted in the World Bank's 2008 “Doing Business Report”, investor protection in Spain is 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 (Extent of Disclosure Index), liability for self-dealing (Extent of Director Liability Index) and shareholders' ability to sue officers and directors for misconduct (Ease of Shareholder Suits Index).

3.4 Model and variable specification

The aim of our paper is to examine the relationship between stock price performance and the ownership structure during periods of market turmoil. To evaluate the different aspects of the ownership structure on stock market performance, we use unbalanced pooled OLS regressions, using ex-post stock market returns as the dependent variable and the different specifications of ownership, sector and size as independent variables defined prior to each period. The use of (unbalanced) pooled OLS stems from the design of turmoil periods.

Rather than having fixed time intervals between the observations, the crisis periods were defined as the largest jumps or plummets over a timer period of 8 years, causing the time between different periods to vary greatly. To control for spurious causality, the independent variable are calculated prior to the turmoil period. The methodology adopted is similar to Mitton (2002) and Baek et al. (2004), but, we control for any changes in the total blockholders' stake to capture changes in the stock price not related to minority shareholders valuation. The regression model estimates the turmoil period return as a function of ownership structure, size and industry:

$$\textit{Stock Price Performance} = f(\textit{Ownership structure variables, size, industry}) \quad (1)$$

Dependent variable

To measure minority shareholder valuation, we use the individual stock price performance, calculated as the relative percent difference between the value of the share at the end of the period and the value at the beginning at the period and control for any changes in the total blockholders' share. For the ten largest jumps and plummets of the stock market index, we calculated the stock price performance for each listed company individually. Table 3.1 presents the exact dates of the first day of the considered up or down market periods. For a trading window of 10 days, the largest jump (15 percent) of the Ibex-35 occurred during the first days of February 2000, while the largest loss (-17.8 percent) was registered during September 2001. For the 20-day and 30-day window, the largest jumps were 19.7 percent and 22.0 percent respectively, while the largest drops were -22.7 percent and -23.0 percent respectively.

To provide addition information of the nature of the identified short term shocks, we have calculated the performance of other leading stock market indices during the exact same periods. We present the comparative stock market movements (averages) in table 3.2. It shows that the French, Italian, German, UK and US stock market indices display a very similar performance compared to the Ibex-35 over the selected periods. The Ibex-35 shows an average loss over a 10 day window of 13 percent, against a loss of 12 percent for the CAC-40, 11 percent for the MIB-30, 13 percent for the DAX-30, 10 percent for the FTSE-100 and an 8 percent loss for the S&P-500 market index, over the exact same periods. Both in up and down market the similarities hold, as well as for the different windows. This indicates that the extreme up and down market we consider in this study are not isolated from other stock markets and are to a large extend the results of events affect the stock market worldwide. These descriptive results give additional validity for the dependent variable as it provides support for the generalizability of this study.

Explanatory variables

For the ownership structure variables, we calculate several measures to test the hypotheses. To measure ownership concentration we use specifications in line with La Porta et al. (1999), Demsetz and Villalonga (2001), De Miguel et al. (2004). Our first measure is the proportion of shares held by the largest shareholder (SH1). Alternatively we also use the proportion held by the three largest (SH1-3) and by the five largest (Sh1-5) shareholders. Furthermore, we investigate the importance of secondary blockholders, who are defined as shareholders with at least 5% of the shares who are not the largest shareholder. We investigate the relationship between the total shareholdings by the secondary blockholders and stock price performance, on the one hand, and the relationship between the number of secondary blockholders and stock price performance, on the other hand.

Table 3.2: Comparative stock market movements of other stock market indices considering the same periods

Trading window	10	10	20	20	30	30
Up/down market	down	up	down	up	down	up
IBEX35	-12.79%	11.09%	-15.32%	14.01%	-16.28%	14.87%
CAC40	-12.37%	9.27%	-13.53%	11.98%	-16.45%	11.54%
MIB30	-10.98%	9.96%	-11.98%	12.09%	-15.63%	10.61%
DAX30	-13.41%	11.58%	-15.42%	14.22%	-17.99%	14.33%
FTSE100	-9.97%	5.19%	-9.28%	8.43%	-12.00%	8.31%
S&P500	-8.14%	5.15%	-8.59%	8.29%	-11.19%	9.03%

Finally, we investigate whether the type of controlling owner affects the share price during periods of soaring or plummeting financial markets. We distinguish between four different types of firms: firms with dispersed ownership, firms controlled by a financial institution, firms controlled by families and firms controlled by a non-financial firm. We classify a firm as a firm with dispersed ownership if the largest shareholder owns less than 20 percent of all shares. This threshold is in line with previous literature (Faccio et al., 2001, Anderson and Reeb, 2003, La Porta, 1999). For firms controlled by a financial institution, the largest shareholder is a financial institution and owns at least 20 percent of all shares. For firms controlled by families, the largest shareholder is an individual or family and owns at least 20 percent. For firms controlled by a non-financial firm, the largest shareholder is a non-financial firm and owns at least 20 percent of all shares.

Control variables

To control for other factors that could affect stock price performance, we include firm size and industry into the regression models. We define firm size in terms of total market capitalization and define four categories: Ibex-35 firms, non-ibex firms with a market capitalization higher than €1000 million, firms with a with a market capitalization between €1000 million and €250 million, and firms with a market capitalization below €250 million.

We define 12 industry categories using the Madrid Stock Exchange classification system. The size and industry categories are stable during the considered periods, eliminating the need to control for within period changes.

3.5 Results

The descriptive statistics of the variables of interest are presented in Table 3.3. The average loss, considering the entire sample over the selected periods is 7.10 percent for a 10 day window, 10.35 percent for a 20-day window and 10.00 percent for a 30-day window. The average gains are 4.66 percent for a 10 day window, 8.08 percent for a 20-day window and 10.57 percent for a 30-day window. The high degree of ownership concentration in Spain is reflected in the different measures of ownership concentration. The average ownership stake of the biggest shareholder is 31.23 percent, while the average proportion of shares held by the three largest shareholders is 42.81 percent and 46.39 percent for the five largest shareholders. These results are similar to the values reported for Spain in De Miguel et al. (2004). In addition, the descriptive statistics confirm the importance of secondary blockholders: the average number of secondary blockholders in Spanish listed companies is 1.35 and the average shareholding by the secondary blockholders is 15.44 percent. To control for stock market movement driven by stock sales or purchases by large shareholders we calculate the total change in total shareholdings by the blockholders during each period. On average, large shareholders very rarely trade during short term periods of market turmoil. For the entire sample, the average change in total shareholdings by the blockholders is only -0.03 percent. Finally, the descriptive statistics show that roughly one third of the firms have a dispersed ownership structure, which is in line with findings by De Miguel et al. (2004), while 17 percent is controlled by a financial institution, 30 percent by a member (or members) of the founding family and 19 percent by a non-founding family.

Table 3.3: Descriptive statistics

Variable	Obs	Mean	Std Dev	Min	Max
Return 10 day window during down market (R10Down)	991	-7.10	7.32	-50.21	23.01
Return 20 day window during down market (R20Down)	1006	-10.35	10.37	-62.32	22.16
Return 30 day window during down market (R30Down)	975	-10.00	15.08	-68.65	204.17
Return 10 day window during up market (R10Up)	936	4.66	8.72	-23.32	76.18
Return 20 day window during up market (R20Up)	1007	8.08	11.42	-28.11	133.38
Return 30 day window during up market (R30Up)	1029	10.57	13.87	-28.28	187.74
Stake of the largest shareholder (SH1)	5895	31.23	25.32	0.00	99.30
Stake of the 3 largest shareholder (SH1-3)	5895	42.81	25.55	0.00	99.51
Stake of the 5 largest shareholder (SH1-5)	5895	46.39	25.94	0.00	99.51
Change in Shareholdings by all blockholders	5895	-0.03	2.82	-40.32	47.91
Number of secondary blockholders	5895	1.35	1.41	0.00	8.00
Shareholdings by secondary blockholders	5895	15.44	13.48	0.00	58.21
Firms with dispersed ownership	5895	0.35	0.48	0.00	1.00
Firm with financial firm control	5895	0.14	0.47	0.00	1.00
Firm with family control	5895	0.34	0.37	0.00	1.00
Firm with non-financial firm control	5895	0.17	0.38	0.00	1.00

Table 3.4 provides the correlations of the different performance measures against the independent variables. The three measures of ownership concentration are positively related to stock price performance during down markets, and negatively related to performance during up markets. Furthermore, the presence of multiple blockholders seems especially beneficial during down markets, as we find that the number of significant shareholders and the total shareholders by the secondary shareholders correlate positively with the stock price performance measures during down markets. Finally, firms with dispersed ownership show negative coefficients during down markets and positive coefficients during up markets, while the exact opposite is true for firms controlled by financial institutions. Firms controlled by families or by non-financial firms show no significant correlation coefficients. The results from the table 3.4 indicate that the results from down markets are fundamentally different from the results from up markets. The correlation coefficients seem to provide some support for the hypotheses 1a, 2a, 2b and 4.

Table 3.4: Correlation matrix

The table represents the correlations between the independent variables and the six different specification of stock price valuation (e.g. R10Down: Stock price Return over a period of 10 trading days during a down market)

	R 10Down	R 20Down	R 30Down	R 10Up	R 20Up	R 30Up
Stake of the largest shareholder	0.12***	0.11***	0.06**	-0.14***	-0.14***	-0.13***
Stake of the 3 largest shareholder	0.14***	0.14***	0.09***	-0.13***	-0.14***	-0.12***
Stake of the 5 largest shareholder	0.15***	0.15***	0.11***	-0.11***	-0.13***	-0.11***
Change in Shareholdings by all blockholders	0.01	0.02	0.00	0.01	0.01	0.01
number of secondary blockholders	0.08***	0.08***	0.09***	0.02	-0.02	0.02
Shareholdings by secondary blockholders	0.06**	0.08***	0.09***	0.04	0.01	0.05
Firm with dispersed ownership	-0.13***	-0.11***	-0.07**	0.11***	0.10***	0.07**
Firm with financial firm control	0.15***	0.15***	0.11***	0.12***	-0.07**	-0.08***
Firm with family control	0.05	0.04	0.01	-0.02	-0.03	-0.02
Firm with non-financial firm control	-0.03	-0.05	-0.04	0.00	-0.03	0.01

*: significant at 10%; **: significant at 5%; ***: significant at 1%

Next, we consider the multiple regression models to test our hypotheses 1-4. Table 3.5 represents the regression analysis considering the relationship between the stock price performance and ownership concentration during extreme down markets. Regressions 1-3 show a consistent positive relationship between the shareholdings by the largest shareholder (SH1) and different specifications of stock price performance. The other two measures of ownership concentration, the shareholdings by the three largest and five largest shareholders, show a very similar relationship. These results provide strong support for hypothesis 1a. The stock price performance is significantly higher for firms with concentrated ownership during extreme down markets. The positive aspects of ownership concentration seem to be larger than the negative elements, like the risk of expropriation or the flight to more liquid (less concentrated) shares, during extreme down markets. Furthermore, we observe that the changes in shareholdings during the considered periods are not significant. This is probably due to the infrequent trading of large shareholdings during periods of stock market turmoil. Finally, small listed companies do not lose more value during extreme down markets compared to large listed firms. This result is relevant to evaluate the existence of a flight to liquidity, as firm included in the stock market index and with more market capitalization are

typically much more liquid. The lack of a size effect means does therefore support the idea that there is no important flight to liquidity during the identified down markets.

Table 3.6 shows the results for the relationship between the stock price performance and ownership concentration during extreme up markets. The results for extreme up markets with respect to ownership concentration are the exact opposite compared to the results from the down market. The three measures of ownership concentration show a negative relationship with stock price performance over a 10, 20 or 30 days window. Firms with less ownership concentration gain more value during extreme up markets. In addition, larger companies, especially those pertaining to the IBEX-35 perform better than smaller companies during extreme up market periods. In sum, the results from table 3.5 and 3.6 show that minority investors attach a significant positive value to ownership concentration during extreme down market periods, while ownership concentration is valued negatively during up market periods. Taking the extreme down and up market results together, the value of firms with concentrated ownership seems to be more stable, during periods of severe external market shocks. The stock price looses less value during an extreme down market but also raises less during an extreme up market.

Table 3.5: Regression analysis: Stock price performance and ownership concentration during down markets

The regression equations consider three specifications (10, 20 and 30 day trading window) of stock price valuation during extreme down markets as the dependent variable. The independent variables include three measures of ownership concentration, the change in total shareholdings by all blockholders, eleven industry dummies and three dummy variables capturing the size of the firm (Ibex35 firms, firms with market cap > €1000 million and firms with €1000 million >market cap> €250 million).

Dependent variable: Stock market return	H	R 10	R 20	R 30	R 10	R 20	R 30	R 10	R 20	R 30
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Intercept		-6.043***	-8.230***	-8.717***	-6.823***	-9.239***	-10.018***	-7.158***	-9.626***	-10.622***
		(0.845)	(1.232)	(1.823)	(0.890)	(1.282)	(1.926)	(0.909)	(1.282)	(1.970)
Stake of the largest shareholder	+	0.033***	0.041***	0.036*						
		(0.009)	(0.013)	(0.023)						
Stake of the 3 largest shareholder	+				0.040***	0.052***	0 .054***			
					(0.009)	(0.013)	(0.023)			
Stake of the 5 largest shareholder	+							0.043***	0.056***	0.062***
								(0.009)	(0.013)	(0.023)
Change in Shareholdings by all blockholders	+	0.112	0.061	0.042	0.116	0.041	0.034	0.120	0.040	0.028
		(0.175)	(0.109)	(0.144)	(0.174)	(0.109)	(0.143)	(0.174)	(0.109)	(0.143)
IBEX35		-0.566	-1.112	-0.064	-0.506	-1.064	0.082	-0.493	-1.074	0.115
		(0.796)	(1.135)	(1.734)	(0.794)	(1.131)	(1.731)	(0.792)	(1.130)	(1.729)
Size_1000		1.084	0.638	1.398	1.001	0.414	1.116	0.830	0.264	0.906
		(0.743)	(1.059)	(1.627)	(0.743)	(1.060)	(1.627)	(0.744)	(1.063)	(1.634)
Size_250		-0.019	0.202	1.402	-0.096	0.033	1.212	-0.184	-0.079	1.052
		(0.684)	(0.979)	(1.476)	(0.683)	(0.979)	(1.473)	(0.683)	(0.981)	(1.475)
Industry		Included	Included	Included	Included	Included	Included	Included	Included	Included
N		983	998	968	983	998	968	983	998	968
R-squared		0.079	0.085	0.045	0.0844	0.090	0.049	0.0871	0.092	0.051
Prob>F		0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000

*: significant at 10%; **: significant at 5%; ***: significant at 1%

Table 3.6: Regression analysis: Stock price performance and ownership concentration during up markets

The regression equations consider three specifications (10, 20 and 30 day trading window) of stock price valuation during extreme up markets as the dependent variable. The independent variables include three measures of ownership concentration, the change in total shareholdings by all blockholders, eleven industry dummies and three dummy variables capturing the size of the firm (Ibex35 firms, firms with market cap > €1000 million and firms with €1000 million >market cap> €250 million).

Dependent variable: Stock market return	H	R 10	R 20	R 30	R 10	R 20	R 30	R 10	R 20	R 30
		(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)
Intercept		5.150***	5.595***	12.959***	5.730***	6.632***	12.959***	5.786***	6.910***	13.864***
		(0.977)	(1.261)	(1.594)	(1.037)	(1.329)	(1.594)	(1.067)	(1.359)	(1.727)
Stake of the largest shareholder	+	-0.051***	-0.066***	-0.076***						
		(0.011)	(0.013)	(0.023)						
Stake of the 3 largest shareholder	+				-0.045***	-0.067***	-0.069***			
					(0.011)	(0.014)	(0.017)			
Stake of the 5 largest shareholder	+							-0.041***	-0.067***	-0.064***
								(0.011)	(0.014)	(0.017)
Change in Shareholdings by all blockholders	+	0.083	0.044	0.020	0.092	0.065	0.034	0.096	0.070	0.041
		(0.117)	(0.112)	(0.112)	(0.117)	(0.112)	(0.112)	(0.117)	(0.112)	(0.112)
IBEX35		2.647***	3.745***	-1.824	2.615***	3.771***	-1.741	2.658***	3.817***	-1.665
		(0.938)	(1.176)	(1.478)	(0.942)	(1.176)	(1.481)	(0.943)	(1.176)	(1.482)
Size_1000		1.028	2.924***	-2.376*	1.039	3.077***	-2.282	1.081	3.193***	-2.219
		(0.890)	(1.101)	(1.387)	(0.895)	(1.104)	(1.394)	(0.901)	(1.109)	(1.400)
Size_250		-0.040	0.841	-3.192**	0.060	0.931	-3.133**	0.106	1.022	-3.076**
		(0.801)	(1.014)	(1.274)	(0.804)	(1.016)	(1.278)	(0.808)	(1.020)	(1.284)
Industry		Included	Included	Included	Included	Included	Included	Included	Included	Included
N		927	998	1020	927	998	1020	927	998	1020
R-squared		0.143	0.126	0.064	0.138	0.126	0.061	0.136	0.125	0.059
Prob>F		0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000

*: significant at 10%; **: significant at 5%; ***: significant at 1%

Table 3.7: Regression analysis: Stock price performance, concentration and secondary blockholders during down markets

The regression equations consider three specifications (10, 20 and 30 day trading window) of stock price performance during extreme down markets as the dependent variable (R10, R20, R30). The independent variables include ownership concentration (defined as the stake of the largest shareholder) and the squared term of ownership concentration, two specifications capturing the secondary blockholders, the change in total shareholdings by all blockholders, eleven industry dummies and three dummy variables capturing the size of the firm (Ibex35 firms, firms with market cap > €1000 million and firms with €1000 million >market cap> €250 million).

Dependent variable: Stock market return	H	R 10	R 20	R 30	R 10	R 20	R 30	R 10	R 20	R 30
		(19)	(20)	(21)	(22)	(23)	(24)	(25)	(26)	(27)
Intercept		-5.830***	-7.817***	-8.113***	-7.549***	-9.908***	-11.678***	-7.499***	-10.063***	-11.787***
		(0.974)	(1.395)	(2.119)	(0.920)	(1.340)	(2.024)	(0.954)	(1.372)	(2.078)
Stake of the largest shareholder	+	0.0181	0.012	-0.004	0.043***	0.053***	0.057***	0.041***	0.052***	0.054***
		(0.034)	(0.047)	(0.074)	(0.009)	(0.013)	(0.021)	(0.009)	(0.013)	(0.020)
Stake of the largest shareholder (squared)	-	0.0002	0.0003	0.0004						
		(0.0003)	(0.0005)	(0.0008)						
number of secondary blockholders	+				0.636***	0.749***	1.216***			
					(0.165)	(0.246)	(0.354)			
Shareholdings by secondary blockholders	+							0.060***	0.077***	0.120***
								(0.019)	(0.026)	(0.039)
Change in Shareholdings by all blockholders	+	0.111	0.063	0.042	0.110	0.059	0.016	0.129	0.037	0.010
		(0.175)	(0.109)	(0.144)	(0.174)	(0.109)	(0.143)	(0.174)	(0.109)	(0.141)
IBEX35		-0.548	-1.074	-0.045	-0.632	-1.246	-0.240	-0.515	-1.154	0.034
		(0.796)	(1.137)	(1.734)	(0.791)	(1.133)	(1.722)	(0.792)	(1.130)	(1.727)
Size_1000		1.167	0.805	1.618	0.794	0.313	0.762	0.794	0.187	0.757
		(0.747)	(1.090)	(1.673)	(0.741)	(1.062)	(1.627)	(0.745)	(1.065)	(1.630)
Size_250		-0.034	0.173	1.348	-0.286	-0.099	0.868	-0.199	-0.114	1.001
		(0.686)	(0.981)	(1.476)	(0.683)	(0.983)	(1.475)	(0.683)	(0.981)	(1.474)
Industry		Included	Included	Included	Included	Included	Included	Included	Included	Included
N		983	998	968	983	998	968	983	998	968
R-squared		0.079	0.085	0.045	0.094	0.093	0.056	0.089	0.093	0.054
Prob>F		0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000

*: significant at 10%; **: significant at 5%; ***: significant at 1%

Table 3.8: Stock price performance, concentration and secondary blockholders during up markets

The regression equations consider three specifications (10, 20 and 30 day trading window) of stock price valuation during extreme up markets as the dependent variable (R10, R20, R30). The independent variables include ownership concentration (defined as the stake of the largest shareholder) and the squared term of ownership concentration, two specifications capturing the secondary blockholders, the change in total shareholdings by all blockholders, eleven industry dummies and three dummy variables capturing the size of the firm (Ibex35 firms, firms with market cap > €1000 million and firms with €1000 million >market cap> €250 million).

Dependent variable: Stock market return	H	R 10	R 20	R 30	R 10	R 20	R 30	R 10	R 20	R 30
		(28)	(29)	(30)	(31)	(32)	(33)	(34)	(35)	(36)
Intercept		5.011***	5.509***	10.629***	5.286***	6.761***	13.098***	4.744***	6.395***	12.370***
		(1.126)	(1.261)	(1.799)	(1.107)	(1.394)	(1.914)	(1.120)	(1.425)	(1.799)
Stake of the largest shareholder	+	-0.041	-0.060	.0891	-0.052***	-0.075***	-0.078***	-0.049***	-0.071***	-0.073***
		(0.040)	(0.013)	(0.062)	(0.011)	(0.014)	(0.017)	(0.012)	(0.014)	(0.017)
Stake of the largest shareholder (squared)	-	-0.0001	-0.00006	-0.002***						
		(0.0004)	(0.0005)	(0.0006)						
number of secondary blockholders	+				-0.054	-0.511*	-0.061			
					(0.201)	(0.263)	(0.3245)			
Shareholdings by secondary blockholders	+							0.016	-0.032	0.025
								(0.022)	(0.027)	(0.036)
Change in Shareholdings by all blockholders	+	0.083	0.044	0.017	0.086	0.059	0.027	0.076	0.056	0.014
		(0.117)	(0.112)	(0.112)	(0.117)	(0.112)	(0.113)	(0.117)	(0.112)	(0.113)
IBEX35		2.643***	3.746***	-2.017	2.643***	3.824***	-1.821	2.673***	3.743***	-1.809
		(0.938)	(1.179)	(1.475)	(0.932)	(1.174)	(1.479)	(0.939)	(1.176)	(1.478)
Size_1000		0.978	2.888***	-3.186**	1.064	3.181***	-2.363	0.957	3.082***	-2.475*
		(0.912)	(1.102)	(1.427)	(0.935)	(1.106)	(1.396)	(0.899)	(1.111)	(1.407)
Size_250		0.048	0.845	-3.113**	0.066	1.125	-3.179**	-0.012	0.964	-3.269**
		(0.802)	(1.015)	(1.270)	(0.806)	(1.020)	(1.275)	(0.806)	(1.020)	(1.280)
Industry		Included	Included	Included	Included	Included	Included	Included	Included	Included
N		927	998	1020	927	998	1020	927	998	1020
R-squared		0.143	0.126	0.072	0.144	0.130	0.065	0.144	0.127	0.065
Prob>F		0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000

*: significant at 10%; **: significant at 5%; ***: significant at 1%

Table 3.7 looks at the hypothesized non-monotonic relationship between ownership concentration and stock price performance, as well as the importance of secondary blockholders during down market periods. Regressions 19-21 introduce the squared term of the total shareholdings by the largest shareholder, into regressions 1-3. The results do not provide support for a quadratic relationship between ownership concentration and stock price performance. In addition, we tested a cubic relationship (although the results are not included in table 3.7) between ownership concentration and stock price performance, but found no significant results. We therefore conclude that the relationship between performance and ownership concentration is linear and positive during down market periods, rejecting hypothesis 1b. Furthermore, regressions 22-27 consider the importance of secondary blockholders. We consider the total number of secondary blockholders as well as the shareholdings by the secondary blockholders. Regressions 22-24 show a significant positive relationship between the number of secondary blockholders and performance, confirming hypothesis 2a. In addition, the shareholdings by the secondary blockholders are also positively related to performance (regressions 25-27), confirming hypothesis 2b. Minority shareholders tend to value the presence of secondary shareholders positively. Larger number of secondary blockholders and more shareholdings by secondary blockholders are perceived to reduce the risk of expropriation or to induce better management.

Table 3.8 looks at the hypothesized non-monotonic relationship between ownership concentration and stock price performance, and the importance of secondary blockholders during up market periods. Similar to the results for the down market, regressions 28-30 do not provide support for a quadric relationship between ownership concentration and stock

price performance. We also tested for a cubic relationship, but found no evidence of such a relationship. We therefore reject hypothesis 1b for extreme up and down market. Ownership concentration presents a linear relationship with stock price performance, during periods of market turmoil. In addition, regressions 31-36 show no relationship between the secondary blockholders, either measured as the number of secondary blockholders either as their shareholdings, and stock price performance. Overall, from tables 3.7 and 3.8, we conclude that the relationship between ownership concentration and stock price performance is linear, rejecting hypothesis 1b. In addition, the presence of multiple blockholders is clearly beneficial during down markets, but shows no significant relationship with stock price performance during up markets. Confirming for hypothesis 2a and 2b is therefore only found during down markets. This could be driven by the increased reliance on multiple blockholders by minority shareholders during down market periods to provide effective monitoring or advice.

The results for the hypotheses related to the relationship between performance and the type of ownership are presented in table 3.9. The regressions 37-39 focus on down market periods and show a significant positive performance for firms controlled by a financial institution and a positive, non-significant, performance for firms controlled by families or by non financial firms (compared to firms with dispersed ownership). In contrast, the regressions 40-42 focus on up market periods and show a negative stock price performance for firms controlled by a financial institution, for firm with family control and for firms controlled by non financial firms. Overall the results seem to indicate that minority shareholders value firm controlled by a financial institution higher during extreme down markets. This is in line with hypothesis 4. One of the reasons for this higher

performance could stem from better monitoring by banks, less incentives to expropriate minority shareholders and the possibility to provide resources to the company during extreme down markets. Taking the results from up and down markets together, it seems that especially the presence of financial institutions could reduce the effect of market shocks. Firms controlled by families or by non-financial firms, also seem to be more stable than firms with dispersed ownership during periods of market turmoil, but less than firms controlled by a financial institution. Table 3.10 presents the same analysis, but uses a 25 percent threshold to define ownership control. The results for the alternative threshold are consistent with the results using a 20 percent threshold.

In summary, the results show the importance of ownership concentration, the presence of multiple blockholders and type of ownership to explain stock market performance. In addition, the analysis shows that the results for extreme down markets are fundamentally different from the up market results. While ownership concentration is valued positively during down market periods, it is valued negatively during up market periods. Furthermore, the presence of multiple blockholders only influences the minority shareholder valuation during down market periods. Finally, firms controlled by a financial institution lose significantly less value during down markets and gain less easily value during extreme up markets. The stock price performance of firms controlled by families or non-financial institutions is only significantly different from firm with dispersed ownership during extreme up markets. It is important to notice that the results are robust for different specification of stock market return, i.e. for 10, 20 or 30 trading days. In addition, although there is some overlap, each window has some specific periods not covered by the other windows, which reinforces the robustness of the findings. Finally, the results are also

robust for different specifications of ownership concentration and multiple blockholders and different thresholds to define controlling shareholders.

Table 3.9: Stock price performance, type of ownership during down/up markets

The regression equations consider three specifications (10, 20 and 30 day trading window) of stock price performance during extreme down and up markets as the dependent variable (R10, R20, R30). The independent variables include three dummy variables capturing the identity of the controlling shareholder (i.e. a financial institution, family or non-financial firm), ownership concentration (defined as the stake of the largest shareholder) and the squared term of ownership concentration, two specifications capturing the secondary blockholders, the change in total shareholdings by all blockholders, eleven industry dummies and three dummy variables capturing the size of the firm (Ibex35 firms, firms with market cap > €1000 million and firms with €1000 million >market cap> €250 million). Firms with controlling owners are defined as firms where the largest shareholder holds at least 20 percent of all shares. Firms where the largest shareholder holds less than 20 percent are considered firms with dispersed ownership.

Dependent variable: Stock market return	R 10	R 20	R 30	R 10	R 20	R 30
Down / Up market	Down	Down	Down	Up	Up	Up
	(37)	(38)	(39)	(40)	(41)	(42)
Intercept	-6.033***	-8.286***	-8.327***	5.862***	6.999***	13.085***
	(1.076)	(1.533)	(2.358)	(1.289)	(1.635)	(2.039)
Firm with financial institution control	3.265***	3.924***	3.955**	-2.449***	-2.547**	-3.182**
	(0.753)	(0.998)	(1.543)	(0.912)	(1.172)	(1.454)
Firm with family control	1.036	1.354	0.827	-2.176**	-3.315***	-2.503*
	(0.724)	(1.008)	(1.526)	(0.862)	(1.088)	(1.372)
Firm with non-financial firm control	0.865	0.922	0.739	-1.662*	-2.547**	-2.286*
	(0.727)	(1.002)	(1.512)	(0.912)	(1.106)	(1.374)
Change in Shareholdings by all blockholders	0.141	0.073	0.041	0.792	0.054	0.016
	(0.177)	(0.108)	(0.144)	(0.122)	(0.117)	(0.117)
IBEX35	-0.476	-0.786	0.041	2.182**	3.553***	-1.489
	(0.806)	(1.131)	(1.723)	(0.973)	(1.213)	(1.524)
Size_1000	0.992	0.659	1.667	0.896	3.069***	-2.222
	(0.771)	(1.081)	(1.634)	(0.942)	(1.171)	(1.455)
Size_250	-0.314	-0.238	0.370	0.289	0.812	-3.182**
	(0.703)	(1.001)	(1.496)	(0.857)	(1.064)	(1.333)
Industry	Included	Included	Included	Included	Included	Included
N	983	998	968	983	998	968
R-squared	0.094	0.106	0.068	0.160	0.125	0.053
Prob>F	0.000	0.000	0.000	0.000	0.000	0.000

*: significant at 10%; **: significant at 5%; ***: significant at 1%

Table 3.10: Sensitivity test - Stock price performance, type of ownership during down/up markets (alternative threshold for control: 25 percent)

The regression equations consider three specifications (10, 20 and 30 day trading window) of stock price performance during extreme down and up markets as the dependent variable (R10, R20, R30). The independent variables include three dummy variables capturing the identity of the controlling shareholder (i.e. a financial institution, family or non-financial firm), ownership concentration (defined as the stake of the largest shareholder) and the squared term of ownership concentration, two specifications capturing the secondary blockholders, the change in total shareholdings by all blockholders, eleven industry dummies and three dummy variables capturing the size of the firm (Ibex35 firms, firms with market cap > €1000 million and firms with €1000 million >market cap> €250 million). Firms with controlling owners are defined as firms where the largest shareholder holds at least 25 percent of all shares. Firms where the largest shareholder holds less than 25 percent are considered firms with dispersed ownership.

Dependent variable: Stock market return	R 10	R 20	R 30	R 10	R 20	R 30
Down / Up market	Down	Down	Down	Up	Up	Up
	(37)	(38)	(39)	(40)	(41)	(42)
Intercept	-5.334***	-7.553***	-7.107***	5.282***	7.159***	11.488***
	(1.020)	(1.423)	(2.158)	(1.235)	(1.531)	(1.899)
Firm with financial firm control	3.514***	3.721***	3.609**	-1.938**	-2.593**	-2.446*
	(0.775)	(0.952)	(1.615)	(0.928)	(1.213)	(1.510)
Firm with family control	0.312	0.604	0.612	-1.648**	-3.974***	-0.927
	(0.697)	(0.956)	(1.458)	(0.830)	(1.045)	(1.302)
Firm with non-financial firm control	0.754	1.119	0.734	-1.275	-2.716**	-1.897
	(0.727)	(1.027)	(1.595)	(0.922)	(1.094)	(1.374)
Change in Shareholdings by all blockholders	0.145	0.073	0.039	0.761	0.049	0.031
	(0.177)	(0.108)	(0.144)	(0.122)	(0.116)	(0.116)
IBEX35	-0.484	-0.839	0.450	2.399**	3.896***	-1.369
	(0.803)	(1.133)	(1.723)	(0.975)	(1.215)	(1.521)
Size_1000	1.133	0.806	2.051	0.881	3.612***	-2.621*
	(0.784)	(1.011)	(1.691)	(0.965)	(1.194)	(1.499)
Size_250	-0.298	-0.148	0.906	0.244	0.986	-3.300**
	(0.692)	(0.983)	(1.482)	(0.847)	(1.055)	(1.324)
Industry	Included	Included	Included	Included	Included	Included
N	983	998	968	983	998	968
R-squared	0.097	0.101	0.064	0.156	0.130	0.051
Prob>F	0.000	0.000	0.000	0.000	0.000	0.000

*: significant at 10%; **: significant at 5%; ***: significant at 1%

3.6 Conclusions and Limitations

Shareholder structures are quite diverse across countries, with dispersed ownership being much more frequent in US and UK listed firms, compared to Continental Europe, where controlled ownership is prevalent. The differences in ownership structure have two obvious consequences for corporate governance: on the one hand, dominant shareholders

have both the incentive and the power to discipline management; on the other hand, concentrated ownership can create conditions for a new problem because the interests of controlling and minority shareholders are not aligned. Since ownership control can have both positive and negative properties, empirical evidence is of paramount importance for judging about its final effect and for orienting regulations. In this study, we investigate the relationship between stock price performance and ownership structure during plummeting and soaring financial markets in a Continental-European setting.

The results show the importance of ownership concentration, the presence of multiple blockholders and the type of controlling owner to explain stock market performance. In addition, the results for extreme down markets are fundamentally different from the up market results. While ownership concentration is valued positively during down market periods, it is valued negatively during up markets. Furthermore, the presence of multiple blockholders only influences the stock price during down market periods. Finally, firms controlled by a financial institution lose significantly less value during down markets and gain less easily value during extreme up markets. The stock price performance of firms controlled by families or non-financial institutions is only significantly different from firm with dispersed ownership during extreme up markets.

The results support the idea that minority investors rely on large shareholders during down market periods to monitor management or pursue maximum firm value. This idea is further supported by positive relationship between multiple blockholders and stock price performance, only during down market periods. Furthermore, combining the findings from extreme up and down markets, there is an indication that ownership concentration is

associated with more stable stock valuation during periods of market turmoil; especially firms controlled by a financial institution tend to lose less value during down markets and gain less value during up markets. Firms with dispersed ownership, on the other hand, seem to be significantly more sensitive to the stock market environment than firms with large controlling shareholders. To the extent that ownership concentration might contribute to the financial and economic stability of listed firms during periods of market turmoil, this study provides empirical insights against regulations that could hamper the persistence of large controlling shareholders.

It is important to notice that the results are robust for different specification of stock market return, i.e. for 10, 20 or 30 trading days. In addition, the results are also robust for different specifications for ownership concentration and multiple blockholders, as well as different thresholds to define firm control. An important limitation to this research is the focus on a single country. However, the country investigated shares the same institutional framework with most Continental European countries and shows many similarities concerning the ownership structure of firms.

Conclusion

Berle and Means (1932) argued that the separation of ownership from control produces a condition where the interests of the owner and the ultimate manager may, and often do, diverge. In the modern corporation, ownership is dispersed among numerous individuals and decision making is done by hired professional management. This allows a concentration of power in the hands of management who may advance their own interests at the cost of the owners' interests. Corporate governance addresses the relationship among the owners and the management (e.g., Monks and Minow, 1996). The central question in corporate governance is how this relationship influences strategy formulation, decision-making, value creation and value distribution (Jensen, Baker, Baldwin and Wruck, 1996).

Recent corporate governance research suggests that a large proportion of public companies worldwide are characterized by controlling stockholders who are more often families, usually the founder(s) or their descendants. For example, Faccio and Lang (2001) report in a study of 5232 publicly traded corporations in 13 Western European countries that 36.93 % were firms with dispersed ownership, while 60.07% have large controlling owners. Thus far, most corporate governance research has focused on stylized US (and to a less extent UK) firms which separate ownership and control. Consequently, there is value in investigating firms outside the Anglo-American world when advancing research on large firms which still combine ownership and control (Carney and Gedajlovic, 2002). A recent

study by De Miguel et al. (2004) find that Spanish majority shareholders manage to expropriate the wealth of minority shareholders, while in other countries – such as the UK, the US, Germany and Japan – this does not occur. They conclude that the results confirm the idea that differences in corporate governance systems lead to different value-ownership relations. The objective of this thesis is to further investigate the role of ownership structure on the effectiveness of other corporate governance mechanisms and the firm's performance.

The first chapter develops a theoretical model to better understand how the role (control versus direction) of the board of directors is influenced by the ownership structure and a how a different role influences the board effectiveness. Most corporate governance research focuses on a universal link between corporate governance practices (e.g., board structure, shareholder activism) and performance outcomes, but neglects how the specific context of each company and diverse environments lead to variations in the effectiveness of different governance practices. An important question addressed in this paper is whether all firms, regardless of their ownership structure, should be submitted to the 'one-rule-fits-all' recommendations of majority non-executive directors, the separation of CEO and chairman, restricted board size, restricted terms of board members and number of board positions held in other companies. The review of the empirical research on the characteristics of the board of directors shows that results are often inconclusive. One reason for the mixed empirical results related to the effectiveness of various governance mechanisms may be the neglect of patterned variations in corporate governance according to the contexts of different organizational environments (Filatotchev, 2008). Universalistic policy prescriptions could therefore lead to important shortcomings and, as a result, they need to be substantially adapted to the local contexts of firms or translated across diverse national institutional

settings (Fiss and Zajac, 2004; Aguilera and Cuervo-Cazurra, 2004). Building on organizational theory and institutional analysis a number of more recent studies make attempt to develop a framework for understanding the influence of organization-environment interdependencies on the effectiveness of corporate governance in terms of the firm's contingencies, complementarities between governance practices and potential costs of corporate governance (e.g., Aguilera et al. 2008; Filatotchev et al. 2006; Aguilera and Jackson, 2003). Our study builds on these arguments and suggests that the effectiveness of a specific corporate governance practice must also be seen in the light of contingencies related to the ownership structure of the firm. The objective of this paper is to understand how the role (control versus direction) of the board of directors is influenced by the ownership structure and a how a different role influences the board effectiveness. While shareholders in firms with dispersed ownership have a great need to use the board of directors to control the management, large controlling shareholders have both the incentive and the power to hold management accountable. The control role of the board is therefore considered to be less important in the presence of concentrated ownership (La Porta et al., 1998; Aguilera, 2005). In this study, we argue that the ownership structure, through the role of the board of directors, influence the effectiveness of the board of directors. When ownership is diffuse, the control role of the board is going to be more important because it is difficult for the dispersed shareholders to co-ordinate their monitoring activities (Davies, 2002; Aguilera, 2005). An important implication is that effectiveness does not result from a universal 'one best way', but suggests that particular practices will be effective only in certain combinations and furthermore may give different patterns of comparative institutional advantages given the contingencies of different environments. Firms with dispersed ownership may obtain higher board effectiveness if their board combines the

following characteristics: a high proportion of outside board members, dual leadership, smaller board size, shorter board tenure and less directorships by its board members. The board in a firm with concentrated ownership on the other hand could be more effective when the board combines the following characteristics: a balance of insiders and outsiders, single leadership structure, larger board size, longer board tenure and more directorships by its board members. In light of scandals and perceived advantages in reforming corporate governance systems, debates have emerged over the appropriateness of implementing corporate governance recommendations mainly based on an Anglo-Saxon context characterized by dispersed ownership where markets for corporate control, legal regulation, and contractual incentives are key governance mechanisms. This paper adds to the literature that argues in favor of the need to adapt corporate governance policies to the local contexts of firms.

The framework suggests that corporate governance recommendations and policy making will be more effective if they take into account the potential diversity of governance mechanisms, which deal with important contingencies. Codes of corporate governance need to be sufficiently flexible to be effective. In addition, from the comparison between the UK, Italian and Spanish codes of corporate governance, it is clear that codes reflect to some extent the specific corporate governance setting within a country. Although within a country, less consideration has been given to the diversity and different needs. Understanding the influence of the board of directors on board effectiveness requires greater sensitivity to how corporate governance affects different aspects of effectiveness for different stakeholders and in different contexts. We argue 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 interested in applying corporate governance in particular situations.

The objective of the second chapter is to offer greater insight into how corporate governance mechanisms are contingent on the ownership structure of the company. We argue that the ownership structure influences the behavior of the board of directors. Boards in firms with dispersed ownership, with a strong focus on control, are more likely to favor a higher demand of audit services relative to boards in firms with ownership concentration, where independent board members contribute with the provision of resources to the management. To assess our arguments, we examine the relationship between board characteristics and the demand for external audit in firm with dispersed and concentrated ownership. The results show that the influence of board independence and single leadership on the external audit demand is contingent on the concentration of ownership. For firms with dispersed ownership, we find that both board independence and single leadership are significantly related to the total audit fees. This is in line with previous literature which typically considers large US or UK companies. In contrast, for firms with concentrated ownership, the relationship between board characteristics and the demand for external audit is insignificant. These results are consistent with the argument that the ownership structure has an important influence on the board behavior. Finally, the study shows that even in countries without a high risk of lawsuits against board members, outside board members demand for more audit, indicating that the higher demand for audit by outside board members is not only driven by the fear of facing a lawsuit.

Our results complement the existing research conducted in the context of dispersed firms and highlight the importance of considering ownership structure patterns for policymakers, since a similar degree of board independence may lead to a different behavior contingent on the ownership structure of the firm. For future research, it may be interesting to look at the interaction between ownership and other corporate governance practices. Ownership control may have a similar influence on voluntary disclosure, compliance with corporate governance codes or the adoption of risk management practices. Finally, our findings suggest that firms with dispersed ownership in a different corporate environment behave similar to UK/US firms. It may, therefore, be interesting to explore in the future whether the reverse would also hold. Do firms with concentrated ownership in the US/UK behave similarly to firms with concentrated ownership in Continental Europe?

This study has several limitations. First it focuses on listed companies with a single board structure. It is therefore possible that the results may not be generalized 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. Finally, previous literature has also studied the relationship between audit committees and external audit, in addition to the board composition. Although audit committees were practically non-existent prior to the early/mid 1990s in Continental Europe, they have been adopted as part of the corporate governance structure within companies as a result of national and international regulatory pressures (Collier land Zaman 2005). However, audit committees for listed companies were only obligatory as of 2003 in Spain, while their creation remains a voluntary decision in France as no explicit regulation exists on audit committees (except for financial institutions). The role of the specialized

committees is to facilitate the work of the board of directors and help with effective preparation of decisions. These committees should not siphon off the board's power, and their role is therefore purely consultative. Given the limited importance of the audit committee in both France and Spain, we study the actions of the board of directors rather than restricting the scope of our investigation to the audit committee.

In sum, chapter 2 shows that some corporate governance mechanisms to run firms effectively hold across corporate governance systems but that it is important to understand what makes firms different within governance systems. We have shown that patterns of ownership are an important characteristic to take into account.

The third chapter deals with the relationship between the ownership structure and stock price performance. Shareholder structures are quite diverse across countries, with dispersed ownership being much more frequent in US and UK listed firms, compared to Continental Europe, where controlled ownership is prevalent. The differences in ownership structure have two obvious consequences for corporate governance: on the one hand, dominant shareholders have both the incentive and the power to discipline management; on the other hand, concentrated ownership can create conditions for a new problem because the interests of controlling and minority shareholders are not aligned. Since ownership control can have both positive and negative properties, empirical evidence is of paramount importance for judging about its final effect and for orienting regulations that could hamper the persistence of large controlling shareholders. Continental European firms adopt a wide variety of ownership structures, going from firms with only small diffuse shareholders to firms with majority shareholders. In addition, a European context also allows studying the

importance of secondary blockholders as well as the importance of different types of the controlling owner on stock price performance.

The results show the importance of ownership concentration, the presence of multiple blockholders and the type of controlling owner to explain stock market performance. In addition, the results for extreme down markets are fundamentally different from the up market results. While ownership concentration is valued positively during down market periods, it is valued negatively during up markets. Furthermore, the presence of multiple blockholders only influences the stock price during down market periods. Finally, firms controlled by a financial institution lose significantly less value during down markets and gain less easily value during extreme up markets. The stock price performance of firms controlled by families or non-financial institutions is only significantly different from firm with dispersed ownership during extreme up markets. The results support the idea that minority investors rely on large shareholders during down market periods to monitor management or pursue maximum firm value. This idea is further supported by positive relationship between multiple blockholders and stock price performance, only during down market periods. Furthermore, combining the findings from extreme up and down markets, there is an indication that ownership concentration is associated with more stable stock valuation during periods of market turmoil; especially firms controlled by a financial institution tend to lose less value during down markets and gain less value during up markets. Firms with dispersed ownership, on the other hand, seem to be significantly more sensitive to the stock market environment than firms with large controlling shareholders. To the extent that ownership concentration might contribute to the financial and economic stability of listed firms during periods of market turmoil, this study provides

empirical insights against regulations that could hamper the persistence of large controlling shareholders.

This study builds on prior research in several ways. First, unlike most existing research, which usually studies just one aspect of ownership structure, we focus on several dimensions of the ownership structure: the ownership concentration, the presence of multiple blockholders and the type of controlling owners. Second, rather than focusing on periods of market crisis, we analyze the stock price performance during extreme down market periods as well as extreme up market periods. Combining both perspectives provides insight into how minority shareholders valuation changes during periods of extreme market turmoil. Our results indicate that ownership concentration is associated with more stable stock valuation during periods of market turmoil; especially firms controlled by a financial institution tend to lose less value during down markets and gain less value during up markets. Third, this is one of the first papers to investigate the importance of ownership structure from a minority investor's perspective using data from a Continental European stock market. In contrast to most previous studies, our data set allows to calculate the ownership structure prior to the periods of interest and to control for stock price movements caused by movements by large blockholders during the period of market turmoil. The results also add to the convergence argument of corporate governance systems, which states that cross-national patterns of corporate governance are converging or will converge on the Anglo-Saxon, capital-market driven model characterized by a sharp separation between ownership and control as this model is more efficient than alternative models such as those underpinning family firms, conglomerates, bank-led groups or worker cooperatives. The findings of this study indicate that the minority shareholders attach a

positive value to ownership concentration, especially if the controlling owner is a financial institution, in periods of extreme down markets. Furthermore, the results seem to indicate that during periods of extreme market turmoil, firms with dispersed ownership are significantly more sensitive to the stock market environment than firms with large controlling shareholders. The results of the study also have implications for policy makers, by showing that firms with concentrated ownership are less subjective to extreme market periods. To the extent that ownership concentration might contribute to the financial and economic stability of listed firms during periods of market turmoil, this study provides empirical insights against regulations that could hamper the persistence of large controlling shareholders.

It is important to notice that the results are robust for different specification of stock market return, i.e. for 10, 20 or 30 trading days. In addition, the results are also robust for different specifications for ownership concentration and multiple blockholders, as well as different thresholds to define firm control. An import limitation to this research is the focus on a single country. However, the country investigated shares the same institutional framework with most Continental European countries and shows many similarities concerning the ownership structure of firms.

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