OWNERSHIP STRUCTURE, AGENCY PROBLEMS, AND AUDITOR CHOICE: EVIDENCE FROM WESTERN EUROPEAN FIRMS

Recent evidence on the ownership structures of Western European firms reveals significant divergence between the ultimate ownership and control rights of the largest controlling shareholder, implying that their conflicting interests with minority shareholders is the main agency problem besetting firms in these countries. Prior research also implies that credible financial reporting constrains controlling shareholders’ opportunism by enabling minority investors to identify any diversion of corporate resources. In this paper, we examine whether external monitoring by a high-quality auditor helps reduce the agency problems embedded in the ultimate ownership structures of Western European firms. Consistent with the incentive alignment effect to maximize firm value to the benefit of all shareholders, we find strong, robust evidence that the demand for a Big Four auditor subsides with the ownership rights of the controlling shareholder. In contrast to recent research on East Asian firms, we find no evidence that the divergence between ownership and control rights affects auditor choice. However, we find that both firms with multiple large shareholders beyond the controlling owner and family-controlled firms are associated with lower demand for Big Four auditors. Collectively, our research suggests that Western European firms rely on superior external monitoring from Big Four auditors to moderate the agency problems evident in their ownership structures.