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**Group-affiliated Firms and audit fees:
Evidence from India**

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ABSTRACT

This study analyzes the role of auditors and affiliation to a business group in corporate governance of firms by examining the audit fees charged to group-affiliated and independent firms. Agency problems in firms may be mitigated by the monitoring provided by controlling investors of firms affiliated to business groups. On the other hand, concentrated ownership may also result in higher agency costs because of inefficient profit distributions, tunneling, and complicated ownership structures. Audit fees are determined by the effort expended and the risks faced by auditors. We examine the relationship between audit fees and Group-affiliation for Indian firms. We find that the audit fees paid to BigN auditors are lower for Group-affiliated firms than non-Group-affiliated firms, but audit fees paid to non-BigN auditors are significantly higher for Group-affiliated and non-Group-affiliated firms, consistent with the idea that BigN auditors recognize the role of Group-affiliation in mitigating the agency conflicts.

1. INTRODUCTION

Business groups dominate the private sector of emerging economies (Khanna and Rivkin [2001]) and form an important part of an emerging economy's private sector. La Porta et al. [1999] argue that the ownership concentration of listed firms is higher in weaker legal environments. In general, group-affiliated firms have concentrated ownership of one or more families with strong ties (Khanna and Rivkin [2001]) and the phenomenon has become a prominent feature of publicly listed firms in the emerging markets (Fan and Wong [2005]).

Business groups in the Indian corporate environment, one of the top emerging economies, dominate the Bombay Stock Exchange (BSE) with 67 percent of total capitalization (Basu and Sen [2015]). There have been several papers analyzing the various aspects of Indian business group affiliation (Khanna and Palepu [2000]; Khanna and Rivkin [2001]; Gopalan et al. [2007]; and Manos et al. [2012]), but there has been very limited research on business group affiliation and auditing. We seek to fill this gap in the literature by analyzing the audit fees paid to Indian group affiliated firms.

The current study analyzes the audit fees for Group-affiliated firms, which play a significant role in the Indian economy.¹ The extant literature posits that the separation of ownership and management results in Type I agency problem, while the conflicts between controlling investors and small investors leads to Type II agency problems. By contrast, investors controlling group-affiliated firms can exercise influence and monitor their firms resulting in less severe Type I agency problems leading to lower demand for high quality auditors. With more severe Type II agency problems, however, Group-affiliated firms have incentive to use high quality auditors to mitigate conflicts with minority shareholders. We follow Fan and Wong [2004] who point out that

“Big 5 firms have international reputations and are generally perceived to be more independent than local auditors” to define auditor quality.

To examine the role of auditors, we use a sample of exchange listed Indian firms between 2001 and 2018 to examine the fees paid to auditors for provision of audit services. Group-affiliation may affect the audit fees paid to BigN and non-BigN auditors. BigN auditors have their reputation to protect and are more likely to exert effort to minimize misstatements. Simultaneously, the effective monitoring by controlling stockholders of Group-affiliated firms can reduce the risk of misstatement of financial reporting. Khanna and Palepu [2000] report higher performance of Group-affiliated firms in India. Gopalan et al. [2007] report significantly lower probability of bankruptcy of Group-affiliated firms than stand-alone firms by the financial support extended within group-affiliated firms. Prior research has also uncovered a risk-sharing phenomenon among group firms (Khanna and Yafeh [2005]). These characteristics of Group-affiliated firms should imply lower effort and audit risk for auditors. On the other hand, Johl et al. [2016] appeal to the extant literature and argue that group affiliation may have negative consequences for the members. For example, George and Kabir [2008] find inefficient profit redistribution as an explanation of underperformance of Group-affiliated and group discount relative to firms not affiliated to any group in India. Bertrand et al. [2002] show that controlling shareholders tunnel resources away from minority investors in business groups in India. Claessens et al. [2006] argue that in general, the complicated ownership structures and linkages between group members may lead to greater agency costs. As a result of the negative effects of Group-affiliation, audit effort and risk may be higher for auditors leading to higher audit fees.

Whether BigN and non-BigN auditors recognize the contrasting features of Group-affiliation and weigh them appropriately to charge audit fees remains an empirical question. Our results

indicate that BigN firms' audit fees for Group-affiliated firms are lower than those for non-Group-affiliated firms but audit fees charged by non-BigN firms are significantly higher for Group-affiliated firms. This evidence is consistent with Khan et al. [2015] for Bangladesh family firms, and Ho and Kang [2013] for US family firms but opposite to the results reported by Fan and Wong [2005] for eight emerging economies and Fang et al. [2017] for China. Our results imply that contrary to BigN auditors, the non-BigN firms do not perceive the advantages of Group-affiliation in reducing the audit effort and risk.

India provides an appropriate context to undertake the study of business groups because although the Indian business groups have been compared to Japanese Keiretsus and Korea Chaebols, there are important differences. Khanna and Palepu [2000] argue that unlike in Japan, there is no group-specific bank to coordinate group activities in India. It is the common board members and family members who perform the coordination role among group members. Bae et al. [2002] state that while the Indian business groups form pyramidal ownership structures, the Korean business groups are defined more accurately by cross-holdings of shares. Therefore, given these differences and the sparse research on issues related to business groups in India when compared with much larger body of research for other major Asian economies, the examination is warranted. Khanna and Palepu [2000] also lists advantages of India as an experimental setting by referring to the presence of large number of business groups, the availability of quality data for individual members of a group, the restriction of membership of a firm to only one group, and the use of well-established accounting standards similar to those followed in advanced economies for preparation of accounts.

Besides examining a different experimental setting, the current study contributes to the extant literature on Group-affiliation firms in a large emerging market in several other ways. Further, this

study also adds to the empirical evidence in auditing literature that Group-affiliated Indian firms have lower audit fees when they select BigN audit firms than non-Group-affiliated firms indicating lower audit effort and risk of Group-affiliated firms assessed by quality BigN auditors. Therefore, the current study extends the results presented Ho and Kang [2013], Fan and Wong [2005], Johl et al. [2016], and Fang et al. [2016] related to audit fees for business groups. The study also helps provide answer to the empirical research issue that while smaller investors are vulnerable to expropriation, they still invest in firms controlled by an entity. The current study contributes to this line of research by reporting that lower audit fees is an indication of a non-controlling investor's faith in transparency of financial reporting and in expecting decisions fair for them.

The remainder of the paper presents the literature review and hypotheses in Section 2, Section 3 presents the Data and Methodology used to test the stated hypotheses, and the empirical results are presented and discussed in Section 4. Section 5 concludes.

2. LITERATURE REVIEW AND HYPOTHESES

An effective corporate governance structure protects investors by reducing the agency problem associated with the separation of management and control. There are several components which form the corporate governance structure in an economy. The board of directors, an active takeover market, judicial systems, and institutional investors are the traditional ways by which the agency problems can be alleviated. Auditors also play an important role in the corporate governance structure of an economy since reputed auditors are likely to conduct an effective audit to safeguard their image.

Jensen and Meckling [1976] argue that the relationship between shareholders and managers of a firm fits the definition of a pure agency relationship. Therefore, the problems that occur because of the separation of ownership and management are also agency problems (Type I). It is

reasonable to expect that the distance between the interests of the manager and outside stockholders determines the magnitude of Type I agency problems. Therefore, increased managerial ownership should be inversely related to the Type I agency problem.

Anderson and Reeb [2003] argue that family ownership can reduce Type I agency problem. They state that, founding families hold equity ownership and board seats in nearly one-third of the Fortune 500 firms in the US. These families hold poorly diversified portfolios and often control the corporations. Consequently, to protect the value of their shareholdings, a family has a strong incentive to monitor the performance of the company it controls. In addition, Chen et al. [2010] report that in the US family owners impose stricter discipline on managers. Consistent with the idea that self-interested large stockholders monitor their companies' management, Villalonga and Amit [2006] provide evidence that family management reduces and can even eliminate the agency conflict with managers.

Simunic [1980] posits that audit fees are an increasing function of the level of audit effort and audit risk faced by an auditor. Bell et al. [2001] document that audit fees are higher when business risk is increased because of higher number of audit hours for risky audits. Bedard and Johnstone [2004] document that auditors plan increased effort and billing rates for clients with earnings manipulation risk and that the positive relationships between earnings manipulation risk and both effort and billing rates are greater for clients that also have heightened corporate governance risk.

Increased ownership concentration reduces the Type I agency problem but exacerbates the Type II agency problem. Therefore, depending on whether the Type I or the Type II agency conflict dominates, the auditors may evaluate the level of effort required for the audit and assess the

associated risk in determining the fees charged for audit services. Therefore, the pricing of higher quality audit services should depend on the magnitude of real and perceived agency problems.

Empirically, Ho and Kang [2013] report that US family firms among S&P 1500 pay lower audit fees and the difference is even more significant for firms in which the family owner is the largest stockholder. Fan and Wong [2005] find that for their sample of eight East Asian economies those firms likely to experience the conflict of interest due to their concentrated ownership structures are more likely to use the services of Big-5 auditors and that the Big-5 auditors taken into account the potential agency conflicts in making their audit fee decisions.

Group-affiliation may affect the audit fees paid to BigN and non-BigN auditors. Simultaneously, the effective monitoring by controlling stockholders of Group-affiliated firms can reduce the risk of misstatement of financial reporting. Further, if Group-affiliated firms have elevated performance there is lower probability of manipulating earnings and financial statements. In addition, if Group-affiliated firms are provided financial support by other firms in the group, there would be lower chances of bankruptcy and liquidation, and smaller audit risk. Several papers provide support for this assertion. For examples, Khanna and Palepu [2000] report higher performance of Group-affiliated firms in India. Gopalan et al. [2007] find significantly lower probability of bankruptcy of Group-affiliated firms when compared with stand-alone firms because of the financial support extended by other Group-affiliated firms. Khanna and Yafeh [2005] provide evidence for risk-sharing phenomenon among group firms. These characteristics of Group-affiliated firms should imply lower effort and audit risk for auditors. However, Johl et al. [2016] argue that group affiliation may have negative consequences for the members. For example, George and Kabir [2008] find inefficient profit redistribution the explanation of underperformance of Group-affiliated and group discount relative to firms not affiliated to any groups in India.

Bertrand et al. [2002] show that controlling shareholders tunnel resources away from minority investors in business groups in India. Claessens et al. [2006] argue that in general, the complicated ownership structures and linkages between group members may lead to greater agency costs. As a result of the negative effects of Group-affiliation, audit effort and risk may be higher for auditors and lead to higher audit fees.

Whether BigN and non-BigN auditors recognize these features equally and charge differential audit fees remains an empirical question. The above discussion leads to our third hypothesis:

Hypothesis: A Group-affiliated firm pays lower (higher) audit fees when a BigN auditor is selected.

3. DATA AND METHODOLOGY

ProWess, a database of Indian firms, maintained by the Center for Monitoring Indian Economy Pvt. Ltd. (CMIE) is our main source of the information required to conduct our analyses.² This database has been used in many recent papers examining issues relevant to India. Indian firms are required to disclose all fees paid to the auditors for providing an audit of the firm's accounts and for certain nonaudit services. These data are disclosed in financial statements prepared by firms. We also require financial data, information about whether a firm is affiliated to a business group, and the stock market data for our sample firms. These data items are extracted from the CMIE database. Our sample period extends from 2001 through 2018 and includes all firms for which the required auditor fee, financial, and market data are available. After the data restrictions, we have 35,347 firm-years.

We propose the following audit fees model to test our hypotheses:

$$LNAUDIT = \alpha_0 + \alpha_1 GROUP + \alpha_2 ATURN + \alpha_3 CURR + \alpha_4 QUICK + \alpha_5 IMR + \alpha_6 LNNAF + \alpha_7 LNTA + \alpha_8 ROA + \alpha_9 RET + \alpha_{10} VAR + \alpha_{11} LEV + \alpha_{12} MB + \alpha_{13} FOROPS + \alpha_{14}$$

Commented [A1]: ?

Commented [A2]: ?

Commented [A3]: ?

$$INITIAL + \alpha_{15} SPECIAL + \alpha_{16} LOSS + \alpha_{17} CEOCHR + \alpha_{18} NUMMEET + \alpha_{19} \\ INSTIT + Industry Controls + Year Controls + \varepsilon$$

In the above equations, the control variables represent corporate governance (*INSTIT*, *NUMMEET*, *CEOCHR*), complexity of operations and audit effort (*ATURN*, *CURR*, *QUICK*, *SPECIAL*, *FOROPS*), size (*LNTA*), risk (*VAR*, *LEV*), performance (*ROA*, *RET*, *MB*, *LOSS*), and the characteristics of the auditor (*BIGN*, *INITIAL*). Extant literature has identified these variables (Simunic [1984]; Parkash and Venable [1993]; Palmrose [1996]; Craswell and Francis [1999]; DeFond et al. [2002]; Whisenant et al. [2003]; Clatworthy et al. [2009]; Ho and Kang [2013]; Johl et al. [2016]). We define the variables we use in our analyses in the notes section.³ We also include the predicted signs of our control variables based on prior research in the tables.

To address the problem of simultaneity in a firms' choice of auditor and audit fees and to address any potential bias in OLS estimates because of self-selection, we employ the Heckman two-stage method (Heckman [1979]; Ho and Kang [2013]). We follow Ho and Kang [2013] and model auditor choice in the first stage. Then we employ the Ordinary Least Square (OLS) regressions to estimate fee models for BigN and non-BigN separately in the second stage.⁴ Since there may be several observations for a firm in our sample, it is possible that our results are affected by the correlations that exist across observations for each firm. In order to avoid the issue of independence, we cluster our standard errors by firms.⁵

4. RESULTS

Our sample period extends from 2001 through 2018 and the final sample contains 35,347 firm-years, of which about fifty-five percent are not affiliated to any business group. Table 1 contains the auditor choice and audit fees for our sample by group affiliation and industry. In Table 1, Panel A, the firm-years for BigN and non-BigN auditors are presented. Out of the 7,225 firm-years with

BigN auditors, 4,277 (59%) are for the firms affiliated to business groups, greater than 2,948 (41%) non-Group-affiliated firm-years. Mean, and median audit fees (Table 1, Panel B) are significantly higher for Group-affiliated firms than for firms that are not affiliated to any business groups. In Panel C of Table 1, we present the industry distribution of our sample firms. The audit fees vary substantially by industry for our sample firms and there is concentration of firms in the *CHEMICAL* industry, while firms in *MINING*, *ELECTRICAL*, and, *DIVERSIFIED* industries have relatively far fewer firms. The Electricity industry has the highest mean audit fees whereas the Textile industry has the lowest.

Table 1: Auditor and audit fees by auditor type and group-affiliation

Panel A: Auditor Type

	All Firms N	Group-affiliated Firms N	Non-Group-affiliated Firms N
BigN Auditor	7,225	4,277	2,948
Non-BigN Auditor	28,122	11,504	16,618
All Firms	35,347	15,781	19,566

Panel B: Group-affiliation (Actual fees in Indian Rupees)

	Audit Fees		
	N	Mean	Median
Group-affiliated Firms	15,781	48,384	15,900
Non-Group-affiliated Firms	19,566	21,166 [†]	6,600 [†]
All Firms	35,347	33,318	9,800

[†]Denotes significant differences between Group-affiliated and Non-Group-affiliated firms at 1% level.

Panel C: Audit fees by industry (Actual fees in Indian Rupees)

Industry	Audit Fees		
	N	Mean	Median
AGRICULTURE	3,685	30,305	9,800
TEXTILE	3,130	16,195	6,600
CHEMICAL	5,631	28,623	9,100
CONSUMER GOODS	1,203	39,270	12,300
CONSTRUCTION	3,386	44,614	15,900
METAL	2,550	35,002	9,100

MANUFACTURING	3,081	32,474	11,100
TRANSPORTATION	2,294	50,305	19,800
MINING	313	34,694	13,300
ELECTRICAL	268	93,625	33,700
TRADING	2,868	16,547	4,600
SERVICES	2,558	39,680	7,900
INFORMATION TECHNOLOGY	3,839	39,788	9,000
DIVERSIFIED	541	24,911	10,500
All Firms	35,347	33,318	9,800

Table 2 includes the summary statistics for our sample categorized on the basis of whether a firm is affiliated to a group. We also test for significant differences in our model variables between the Group-affiliated and non-Group-affiliated subgroups. The mean (median) audit fees (*LNAUDIT*) for Group-affiliated firms is statistically higher than the mean (median) audit fees for non-Group-affiliated firms. The mean (median) size (*LNTA*) of Group-affiliated firms is also statistically higher than the mean (median) size of non-Group-affiliated firms, which could be a reason for the audit fees differential. The mean (median) non-audit fee (*LNNAF*) for Group-affiliated firms is statistically higher than the mean (median) audit fees for non-Group-affiliated firms. Twenty seven percent of the Group-affiliated firms have hired BigN audit firms whereas only 15% of the non-Group-affiliated firms have hired BigN audit firms and the difference is significant. While the Group-affiliated firms have significantly higher median special items than non-Group-affiliated firms, the mean and median asset turnover, current and quick ratios, investment opportunities are significantly higher for non-Group-affiliated firms.

Table 2: Descriptive sample statistics

Variable	Non-Group-affiliated Firms			Group-affiliated Firms		
	N	Mean	Median	N	Mean	Median
LNAUDIT	19,566	8.99	8.79	15,781	9.74 [†]	9.67 [†]
LNNAF	19,566	4.45	7.24	15,781	6.71 [†]	8.39 [†]
ATURN	19,566	0.95	0.86	15,781	0.86 [†]	0.77 [†]
CURR	19,566	1.65	0.95	15,781	1.19 [†]	0.21 [†]

QUICK	19,566	1.25	0.49	15,781	0.91 [†]	0.12 [†]
LNTA	19,566	21.2	21.05	15,781	22.29 [†]	22.16 [†]
ROA	19,566	0.03	0.03	15,781	0.03	0.03
RET	19,566	0.3	0.05	15,781	0.34	0.07 [†]
VAR*100	19,566	0.21	0.14	15,781	0.18	0.11 [†]
SPECIAL*100	19,566	0.72	0.03	15,781	0.72	0.07 [†]
LEV	19,566	0.16	0.01	15,781	0.15	0.00 [†]
MB	19,566	1.05	0.68	15,781	0.98 [†]	0.64 [†]
NUMMEET	19,566	1.81	1.79	15,781	1.95 [†]	2.08 [†]
INSTIT	19,566	6.12	1.01	15,781	10.76 [†]	6.23 [†]
BIGN	19,566	0.15		15,781	0.27 [†]	
INITIAL	19,566	0.27		15,781	0.19 [†]	
FOROPS	19,566	0.6		15,781	0.66 [†]	
LOSS	19,566	0.34		15,781	0.35 [†]	
CEOCHR	19,566	0.34		15,781	0.26 [†]	

[†]Denotes significant differences between Group-affiliated and Non-Group-affiliated firms at 1% level.

In Table 3, we examine sample correlations of audit fees with the exogenous variables in our models. The Group-affiliation variable (*GROUP*) has significant correlation with *LNAUDIT*. On the univariate basis most of our model variables, except special items are significantly correlated with audit fees.

Table 3: Correlations with audit fees

Variable	CORRELATION
LNNAF	0.63***
BIGN	0.54***
ATURN	-0.03***
CURR	-0.05***
QUICK	-0.04***
LNTA	0.80***
ROA	0.09***
RET	-0.02***
VAR	-0.05***

LEV	-0.03***
MB	0.15***
INITIAL	0.03***
FOROPS	0.20***
SPECIAL	-0.01
LOSS	-0.17***
CEOCHR	-0.03***
NUMMEET	0.50***
INSTIT	0.52***

***Denotes significant differences at 1% level.

Table 4 presents the audit fees regression results using the Heckman 2-stage to test our hypothesis that Group-affiliated firms pay lower audit fees when BigN auditors are selected. The first two columns of the table include the regression results for firms employing BigN audit firms and the last two columns of the table contain the results with those sample firms using non-BigN audit firms. The *R*-squares of the regressions are high indicating that our models explain most of the variation in the audit fees. The coefficient of *GROUP* for BIGN firms is negative at the 1% significance level, indicating that Group-affiliated firms pay lower audit fees than non-Group affiliated firms when BigN auditors are selected. This suggests that BigN auditors recognize that group-affiliation provides a way to ameliorate the agency problems between dominant and minority shareholders. Larger firms and firms with larger turnover, size, number of board meetings and foreign operations, special items, and CEO being the chairperson of the board tend to pay higher audit fees. In the next two columns, we observe that the co-efficient of the variable of interest, *GROUP*, is positive at 5% significance level indicating that non-BigN auditors do not value the increased monitoring because of Group-affiliation. Higher turnover ratio, nonaudit fees, firm size, foreign operations, presence of special items, incurring negative net income in the previous two fiscal years, CEO being the chairperson of the board, number of board meetings, and

institutional ownership are associated with higher audit fees, but higher current ratios and returns, and new auditors lead to lower audit fees for firms which choose non-BigN auditors.

Commented [A4]: ?

TABLE 4: Audit Fees Model

Variable	Prediction	BIGN=1		BIGN=0	
		Coefficient	p-value	Coefficient	p-value
INTERCEPT	+/-	2.985	0.02**	2.519	0.00***
GROUP	?	-0.159	0.00***	0.065	0.02**
ATURN	+	0.145	0.00***	0.045	0.00***
CURR	-	-0.026	0.57	-0.001	0.06*
QUICK	-	0.023	0.61	0.001	0.22
IMR	+	-2.311	0.00***	-1.774	0.00***
LNNAF	+	0.014	0.00***	0.049	0.00***
LNTA	+	0.387	0.00***	0.325	0.00***
ROA	-	-0.158	0.02**	-0.038	0.02**
RET	-	-0.012	0.13	-0.001	0.76
VAR	+	-0.258	0.00***	0.206	0.13
LEV	+	0.173	0.14	-0.006	0.55
MB	+	-0.015	0.20	0.006	0.29
FOROPS	+	0.200	0.00***	0.152	0.00***
INITIAL	?	-0.043	0.09*	-0.052	0.00***
SPECIAL	+	0.446	0.01***	0.138	0.00***
LOSS	+	0.020	0.56	0.041	0.02**
CEOCHR	+	0.179	0.01***	0.063	0.01***
NUMMEET	+	0.111	0.01***	0.171	0.00***
INSTIT	+	-0.004	0.07*	0.005	0.00***
INDUSTRY		CONTROLLED		CONTROLLED	
YEAR		CONTROLLED		CONTROLLED	
NOBS		7,225		28,122	
R2		0.72		0.67	

***, **, *Significant at the 1%, 5%, and 10% level respectively.

In Table 2, we document differences between firms that are group-affiliated and not for several of our variables. It is possible that our results showing differences in audit fees for group-affiliated and independent firms are driven by these underlying differences. To mitigate the possibility, we use the propensity score matching (PSM) technique. To implement the PSM, we first run a logistic regression on firm characteristics to estimate the probability of belonging to a business group. We

then match a group-affiliated firm with an independent firm using the propensity scores. The results for the PSM samples are provided in Table 5. The results are qualitatively similar to those reported in Table 4 and support our assertion that BigN auditors take into account the ameliorating effect of group-affiliation with respect to the dominant and minority stockholders.

Table 5: Audit Fees Model using Propensity Score Matching

Variable	BIGN=1		BIGN=0	
	Coefficient	p-value	Coefficient	p-value
INTERCEPT	2.581	0.01***	1.573	0.00***
GROUP	-0.070	0.09*	0.112	0.00***
ATURN	0.129	0.00***	0.065	0.00***
CURR	-0.033	0.47	-0.002	0.00***
QUICK	0.031	0.50	0.002	0.00***
IMR	-2.059	0.00***	-1.307	0.00***
LNNAF	0.015	0.00***	0.049	0.00***
LNTA	0.397	0.00***	0.349	0.00***
ROA	-0.091	0.20	-0.035	0.05**
RET	-0.018	0.03**	-0.003	0.45
VAR	-0.267	0.00***	0.112	0.31
LEV	0.228	0.03**	-0.011	0.30
MB	-0.015	0.16	0.010	0.08*
FOROPS	0.177	0.00***	0.185	0.00***
INITIAL	-0.021	0.40	-0.052	0.01***
SPECIAL	0.537	0.02**	0.134	0.02**
LOSS	0.006	0.87	0.033	0.10*
CEOCHR	0.145	0.03**	0.029	0.35
NUMMEET	0.096	0.02**	0.179	0.00***
INSTIT	-0.002	0.26	0.005	0.00***
INDUSTRY	CONTROLLED		CONTROLLED	
YEAR	CONTROLLED		CONTROLLED	
NOBS	5,184		19,642	
R2	0.69		0.64	

***, **, *Significant at the 1%, 5%, and 10% level respectively.

5. CONCLUSION

Financial economists have long argued that the separation of ownership and control gives rise to Type I agency problems and the control differential between dominant and minority shareholder

leads to Type II agency problems. Traditional means of corporate governance are generally found to be weaker in emerging markets. Auditors help alleviate the agency conflicts by creditable attestation of the financial statements of a corporation. Literature also suggests that affiliation to a business group also reduces agency conflicts by providing another mechanism to monitor a firm's managers. We provide evidence that the increased monitoring and reduced audit risk due to membership in a business group results in lower audit fees. Our research provides insights into the determinants of audit fees for an increasingly important political jurisdiction and provides insights into the link between monitoring and audit fees charged by.

Given the relationships among Group-affiliation and lower audit fees in India, future research may investigate other group characteristics like number of firms in the group, size of firms in the group, and industry concentration to explore the audit fee differential.

NOTES

1. In India and other emerging markets, family owned firms and firms affiliated to groups share similarities in their ownership structure. For examples, Khanna and Palepu (2000) observe that Indian Group-affiliated firms are usually owned and controlled by a family to a significant degree. Khanna and Rivkin (2001) observe that group-affiliated firms have concentrated ownership of one or more families with strong ties and Fan and Wong (2005) find that the phenomenon has become a prominent feature of publically listed firms in the emerging markets. Therefore, the arguments in the literature for family-controlled firms also apply to group-controlled firms in the Indian context.

2. <http://www.cmie.com/>

3. **GROUP** An indicator variable equal to 1 if the firm belongs to a business group; 0 otherwise.

<i>BIGN</i>	An indicator variable equal to 1 if the auditing firm is an affiliate of Deloitte, Pricewaterhouse Coopers, Ernst & Young, KPMG, or Arthur Andersen ; 0 otherwise.
<i>LNTA</i>	The natural log of total assets.
<i>LNAUDIT</i>	The natural log of audit fees in Indian rupee.
<i>LNNAF</i>	The natural log of non-audit fee in Indian rupee.
<i>ATURN</i>	The asset turnover ratio.
<i>CURR</i>	The current ratio.
<i>QUICK</i>	The quick ratio.
<i>ROA</i>	Return on assets defined as net income divided by total assets.
<i>RET</i>	The annual raw return over the previous fiscal year.
<i>VAR</i>	The variance of residuals from the market model over the previous fiscal year.
<i>LEV</i>	Total debt to total assets.
<i>MB</i>	The market to book ratio computed as the market value of equity plus book value of debt divided by total assets.
<i>SPECIAL</i>	Defined as the absolute value of special items scaled by total assets, where special items include provisions, write-offs, expenses related to discontinued operations, and items related to merger & acquisitions activities.
<i>INSTIT</i>	Institutional ownership.
<i>NUMMEET</i>	The natural log of the number of board meetings.
<i>CEOCHR</i>	An indicator variable equal to 1 if the CEO is also the chairperson of the board; 0 otherwise.
<i>LOSS</i>	An indicator variable equal to 1 if the firm incurred negative net income in the previous two fiscal years; 0 otherwise.
<i>FOROPS</i>	An indicator variable equal to 1 if the firm had income from foreign sources; 0 otherwise.
<i>INITIAL</i>	An indicator variable equal to 1 if the auditor engagement was less than two fiscals ago; 0 otherwise.

4. For comparison, we also ran our regressions using single-stage OLS and obtain similar results.

5. We are thankful to a reviewer for pointing out the problem of independence when using multiple observations for a firm.

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