

# Voting on Auditor Ratification by Shareholder Type: Impact of Institutional Shareholder Dissent on NAS Fees and Audit Quality

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## Abstract

Institutional investors have a better understanding of corporate performance than non-institutional investors, and their presence tends to improve the overall governance mechanism of a company and discipline top management against taking self-serving or myopic decisions. In this study, we examine shareholder voting patterns on auditor reappointments in Indian companies and examine whether institutional shareholder dissent on auditor reappointment acts as a disciplining mechanism on subsequent auditor actions and leads to improvement in audit quality. Our results indicate that institutional shareholder dissent on auditor reappointment is positively related to relative magnitude of non-audit services (NAS) fees in the previous year. More importantly, we observe that auditors are sensitive to institutional dissent and respond by charging a lower amount of NAS fees and providing superior audit quality in the subsequent year to signal increased independence and objectivity. Similar results are not observed in the case of retail shareholders. Our findings reinforce the role of institutional shareholders as important monitors in the corporate governance process and call for regulation to mandate the participation of shareholders in the auditor appointment process.

## Keywords

shareholder voting, auditor ratification, institutional investors, non-audit services, audit quality, discretionary accruals

## Introduction

The objective of this article is to examine the association between dissent by different types of shareholders in the context of auditor ratification voting and (a) non-audit service (NAS) fees paid to external auditors and (b) subsequent audit quality. Motivation for this article comes from three angles. First, shareholder voting on auditor ratification is an

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important element in the framework of corporate governance (Aguilar, 2012; Dao et al., 2012; Mayhew & Pike, 2004; Raghunandan, 2003). Second, the presence of institutional investors improves the overall governance culture of a company (Appel et al., 2016; Bushee, 1998; Bushee et al., 2014; McCahery et al., 2016). Third, prior research has documented a negative relationship between non-audit service (NAS) fees and audit quality, both of which have long been of interest to regulators and legislators (Sarbanes-Oxley Act [SOX], 2002; Securities and Exchange Commission [SEC], 2000, 2003). Using data from 1,188 auditor reappointments in Indian companies, we examine voting dissent by shareholder type (institutional versus retail) and find that dissent by institutional investors (but not by retail investors) for auditor reappointment is associated with the NAS fee ratio of the prior fiscal year. More importantly, we observe that auditors are sensitive to dissent by institutional (but not retail) investors and respond by (a) charging lower NAS fees, and (b) providing better audit quality in the subsequent year.

Shareholder voting in general is a significant element in the monitoring and disciplining mechanism of corporate governance because it can influence the decisions of managers and directors (Armstrong et al., 2013; Ferri & Sandino, 2009; Lee & Souther, 2020). In the current corporate governance framework, shareholders elect a board of directors to monitor management, and the audit committee of the board hires the external auditor to attest to the financial reports prepared by management; such audits provide the assurance necessary for shareholders about the credibility of financial statements prepared by management. Since the primary purpose of an independent audit is to provide assurance to shareholders, management's (direct or indirect) influence over auditor selection is a threat to auditor independence (Dao et al., 2012; Mayhew, 2017; Saul, 1996). Voting on auditor ratification thus provides shareholders a more direct stake in the selection of the external auditor since in practice it is not possible for all shareholders to select the auditor directly (Brown, 2012; U.S. Department of the Treasury, 2008).<sup>1</sup> Consistent with such arguments, empirical evidence indicates that shareholder ratification is associated with higher audit quality (Dao et al., 2012).

Prior research also indicates that there are significant differences in the ability and effectiveness of different types of shareholders to monitor management. Empirical evidence suggests that institutional investors have a better understanding of corporate performance than non-institutional investors (Collins et al., 2003; Jiambalvo et al., 2002; Utama & Cready, 1997). Furthermore, the presence of institutional investors tends to improve the overall governance mechanism of a company and discipline top management against taking self-serving or myopic decisions (Appel et al., 2016; Bushee, 1998; Bushee et al., 2014; McCahery et al., 2016). In addition, studies also indicate that there are significant differences in the voting behavior of institutional and retail shareholders (Lee & Souther, 2020) and that institutional investors are more successful in influencing corporate policies (I. Kim et al., 2019).

In this study, we hypothesize that institutional shareholders will be more sensitive to factors that could potentially impair audit quality compared with retail investors which, in turn, would impact their voting in the context of reappointment of the auditor. Furthermore, we also hypothesize that dissent by institutional investors would be more likely to lead to subsequent changes in the decisions of auditors with respect to actions that impact audit quality and perceptions of audit quality. Therefore, we analyze shareholder voting patterns for auditor reappointment and examine (a) whether the quantum of NAS purchased affects institutional shareholder dissent on auditor reappointment for the subsequent year; and (b) whether institutional shareholder dissent is related to change in the magnitude of NAS fees

and audit quality in the subsequent financial year. More specifically, we examine whether institutional shareholder dissent acts as a disciplining mechanism on subsequent auditor actions, which in turn leads to superior audit quality as measured by lower magnitude of discretionary accruals and lower NAS fees.

We employ data from India to analyze our research questions. There are three primary reasons for employing Indian voting data in this study. First, unlike in other countries such as the United States, in India, shareholder voting information is available separately for both institutional and non-institutional (i.e., retail) shareholders for any matter that is voted upon in the annual meeting of shareholders. Such distinct disclosures allow us to isolate and examine the impact of institutional shareholder voting using actual voting data rather than relying on assumptions about voting by institutional shareholders. Second, unlike in the United States, shareholder votes on auditor appointment in Indian companies are binding on the company. In case of a majority dissent, the company is required to propose a new auditor for appointment. The binding power of shareholder votes makes the auditors and management more sensitive to any indication of shareholder dissatisfaction and provides a stronger research context to examine the implications of these votes on subsequent audit outcomes. Third, India is an increasingly important country in the global economy<sup>2</sup> that shares several similarities with the traditional capitalist economies even while having some distinct regulatory differences (such as the requirement for separate disclosures of votes by institutional and retail shareholders).

To test our research questions, we collect data related to shareholder voting patterns and shareholder dissent on auditor reappointment resolutions in the annual general meeting (AGM) for financial year  $t$  and examine its relationship with NAS fees and magnitude of discretionary accruals in the subsequent financial year  $t + 1$ . Specifically, we examine resolutions to ratify the auditor for the financial year  $t + 1$ , which are proposed at the AGM held after the conclusion of the immediately preceding financial year  $t$ .

Regulators and legislators in the United States and elsewhere (e.g., European Union [EU], 2014; Indian Companies Act, 2013; SEC, 2000, 2003) have long expressed concerns about the impact of non-audit fees on auditor independence. Some prior studies indicate that NAS fees are associated with lower auditor objectivity and independence (Ashbaugh et al., 2003; Krishnan et al., 2005, 2011). We find that institutional shareholders' dissent for auditor reappointment varies positively with the NAS fee ratio in year  $t$ . However, retail shareholders' dissent is not associated with the NAS fee ratio.

Shareholder voting is only the first step in the monitoring process. The second, and perhaps more important, step would be reactions to such voting by management and others. We argue that auditors will be sensitive to shareholder dissent related to their appointment, especially by the better-informed institutional shareholders. As a result, auditors facing greater dissent in their reappointment process could try and reduce NAS fees to signal greater independence and objectivity and appease the dissenting shareholders. Similarly, auditors can respond to institutional shareholders' dissatisfaction by demonstrating increased vigilance and curbing any opportunistic behavior on part of the management. Therefore, greater dissent on the auditors' reappointment by such shareholders could force the auditors to act more conservatively which in turn could result in allowing relatively lower discretion to management while reporting the financial results in the year subsequent to their reappointment.

The results of our analysis indicate that change in the NAS fee ratio between years  $t$  and  $t + 1$  is negatively associated with the level of institutional shareholder dissent on auditor reappointment resolutions. The same relationship does not hold for individual/retail

shareholder dissent. Similarly, the change in discretionary accruals between years  $t$  and  $t + 1$  is negatively associated with level of institutional shareholder dissent but not related to level of individual/retail shareholder dissent. These results suggest that auditors are sensitive to dissent by the more informed institutional shareholders. This in turn disciplines the auditors' behavior subsequent to such dissent and results in superior audit quality and reduction of factors (NAS fees) that impair (or, are perceived to impair) auditor independence and objectivity.

In contemporaneous research, Cassell et al. (2022) use data from the United States and show that the auditor ratification vote is associated with factors that do not reflect auditor performance when retail ownership is higher. Our use of Indian data enables us to examine the question without any assumptions about voting patterns and corroborates the argument that retail shareholders may be less informed and that their votes can limit the efficacy of shareholder voting as a corporate governance tool.<sup>3</sup>

The findings of our study are important to both regulators and shareholders. Auditors have a central role in providing assurance to shareholders about the financial reports issued by managers. Yet, notwithstanding empirical evidence about the benefits accruing from shareholder voting on auditor ratification (e.g., Dao et al., 2012; Mayhew & Pike, 2004), it is not mandatory to put auditor appointment resolutions for ratification voting in many countries. We provide evidence of the monitoring role of institutional shareholders and their influence on audit outcomes thus underlining the importance of their participation in the company's governance process, as also the efficacy of auditor ratification voting as a monitoring mechanism. Our findings are also relevant in light of efforts by regulators in some countries to increase the participation of retail shareholders in the governance process (e.g., SEC, 2018).

The next section discusses the background and develops the hypotheses. This is followed by a description of method, including data. After discussing the results, the article concludes with a summary and discussion.

## **Background, Related Research, and Hypotheses**

Independent external auditing is an important element in the modern capitalist economy. Such audits reduce the agency conflicts between shareholders (principals) and managers (agents). However, for a long time, given the widely distributed nature of ownership in large corporations, managers had a primary role in the selection of the external auditor (Brown, 2012). Mayhew (2017) notes the problems with such an arrangement:

Management's influence over the auditor has long been recognized as a threat to independence and audit quality. It is, quite simply, difficult to believe that the auditor can objectively attest to the veracity of the financial statements prepared by the same party who hires and fires the auditor. Auditor ratification arose as a mechanism that quickly evolved to give shareholders a more direct stake in the audit process.

In the United States, SOX formally vested the authority to hire and compensate the external auditor with the audit committee of the Board of Directors. Similar legislation in other countries, enacted post-SOX, also codifies that the audit committee is responsible for hiring and compensating the auditor. Nevertheless, in practice, managers continue to have significant informal influence over the hiring of the auditor (Dao et al., 2012).

Consequently, shareholder ratification of the auditor provides some degree of involvement of the shareholders in hiring the auditor that is supposed to protect their interests.

The provisions related to appointment of auditors in Indian companies are laid down in the Companies Act, 2013 (hereinafter referred to as “the Act”), which became applicable from fiscal year 2014–2015 onward. As per the Act, the audit committee, consisting of a majority of independent directors, is vested with the responsibility of making recommendation for the appointment, remuneration, and terms of appointment of the auditors. The recommendations of the audit committee are placed for shareholders’ approval at the annual general meeting (AGM) of the firm.<sup>4</sup> However, it is noteworthy that the auditor’s *remuneration* as envisaged in the Act does not include the payment, if any, to the auditor for non-audit services (NAS). This important distinction implies that while shareholders are given an opportunity to vote on the audit committee’s recommendation related to auditor’s appointment, shareholders do not have any say in the purchase of non-audit services from the auditors. Although the Act prohibits auditors from providing certain NAS,<sup>5</sup> auditors in India continue to provide the NAS that are not within the ambit of the prohibited list, of which legal services and tax consultancy services are the most common.<sup>6</sup>

Prior research indicates that shareholder involvement in the auditor selection process improves audit quality. Mayhew and Pike (2004) argue that top managements’ ability to hire and fire auditors at their discretion can be controlled if auditor appointment is ratified by the shareholders of a company. In an experimental setting, Mayhew and Pike (2004) indicate that shifting power of auditor appointment from top management to shareholders’ increases auditor independence and objectivity and results in superior audit quality. Dao et al. (2012) validate Mayhew and Pike (2004) in an archival setting. Their results indicate that firms that submit auditor appointment resolutions for shareholder ratification voting paid higher audit fees and enjoyed superior audit quality as evidenced by a lower magnitude of discretionary accruals, and were less likely to restate earnings in the future compared with firms that did not vote on auditor appointment decisions. Barua et al. (2017) show that a higher proportion of dissent votes or abstention on auditor ratification is associated with subsequent auditor dismissals. Thus, shareholder ratification of the auditor can be an important element in the governance and monitoring mechanisms of public companies.

Another stream of research suggests that the extent and effectiveness of monitoring varies with the type of shareholders. A typical company has two major types of shareholders: Institutional shareholders (e.g., pension funds, endowment funds, insurance companies, commercial banks, mutual funds, hedge funds) and individual or retail shareholders. Research indicates that institutional shareholders have a better understanding of a company’s workings and performance and are considered to be more sophisticated than retail shareholders (Aggarwal et al., 2015; Collins et al., 2003; Gillan & Starks, 2000; Jiambalvo et al., 2002). Bushee (1998) suggests that presence of institutional investors reduces pressure on top management during periods of earnings decline to maintain targeted earnings levels and as a result top management is less likely to discretionarily reduce research and development expenses to manage earnings. Jiambalvo et al. (2002) indicate that companies with greater institutional investors enjoy a stronger relationship between reported earnings and stock prices as institutional investors are better at incorporating value relevant information in the stock prices. Edmans (2009) suggests that institutional shareholders force top management to focus on creating long term growth rather than short term profits. Greater presence of institutional investors is also associated with appropriate pricing of accruals in stock prices (Collins et al., 2003; Zeng et al., 2013).

Research also indicates that institutional investors are more likely to actively participate in the corporate governance process and as a result discipline top management (Bushee et al., 2014; Chen et al., 2007). Results from prior studies indicate that institutional investors who typically have a long-term investing horizon prefer superior corporate governance mechanisms (Appel et al., 2016; Bushee et al., 2014; Chen et al., 2007; McCahery et al., 2016). In addition, the share buying and selling activities of institutional investors also act as a disciplining mechanism for top management (Bharath et al., 2013; Helwege et al., 2012). Given the ability of institutional shareholders to influence the actions of management, we posit that institutional shareholder voting on auditor ratification is more likely, than corresponding voting by retail shareholders, to be associated with subsequent audit-related outcomes.

Regulators and legislators around the world have long expressed concerns about the impact of non-audit service fees on auditor independence and audit quality (Companies Act, 2013; EU, 2014; SEC, 2000, 2003; U.S. Senate, 1977, 2002). Some prior studies also show that NAS fees are associated with lower auditor objectivity and independence (Frankel et al., 2002; Krishnan et al., 2005, 2011). Consistent with such concerns, prior studies find that a greater proportion of shareholders is likely to vote against, or abstain from, the ratification of the external auditor when the non-audit fee ratio is high (Hermanson et al., 2019; Mishra et al., 2005; Raghunandan, 2003).

Based on prior research, we argue that institutional investors have a better understanding of corporate matters and are more likely to actively participate in a company's affairs (Appel et al., 2016; Bushee et al., 2014; Chen et al., 2007; McCahery et al., 2016). As a result, they would be more likely to dissent on matters that adversely impact the company such as lack of auditor objectivity and independence caused by relatively high NAS. Hence, the institutional investors are more likely to dissent to high NAS compared with the retail investors. Formally stated:

**Hypothesis 1 (H1):** Higher NAS fees are positively associated with institutional shareholder dissent on auditor reappointment resolutions.

Auditors and top management of a company would be sensitive to institutional shareholder dissent and their ability to discipline the company for weak corporate governance either through shareholder activism or their stock buying and selling decisions (Appel et al., 2016; Bharath et al., 2013; Helwege et al., 2012; McCahery et al., 2016). Therefore, auditors and top management would be more likely to react to shareholder voting dissent by taking steps to appease the institutional shareholders and correct the potential cause of their dissent. Hence, we expect that in the face of higher institutional investor dissent, auditors and managers would act together to reduce NAS fees to signal greater auditor independence and objectivity. Given the importance of NAS fee ratios in perceptions of auditor independence, we expect the ratio of NAS fees to reduce significantly in the year subsequent to the institutional investors expressing dissent on the auditor reappointment. Thus, our second hypothesis is:

**Hypothesis 2 (H2):** Institutional shareholder dissent on auditor reappointment resolutions will be negatively associated with the change in ratio of NAS fees to audit fees in the year following the dissent.

Voting on auditor appointment resolutions by the shareholders of a company can potentially reduce the auditor's reliance on top management of a company to acquire and retain clients and provide greater oversight by the "principal" (i.e., shareholders) over the "agent's" (i.e., top management) actions (Mayhew & Pike, 2004). Any dissent by the shareholders on an auditor reappointment resolution could be an indicator of subpar audit quality (Sainty et al., 2002). Consistent with this argument, prior research indicates that dissent by shareholders on auditor ratification is related to subsequent auditor dismissals (Barua et al., 2017) or increased audit effort and improved audit outcomes in the subsequent year (Tanyi et al., 2020).

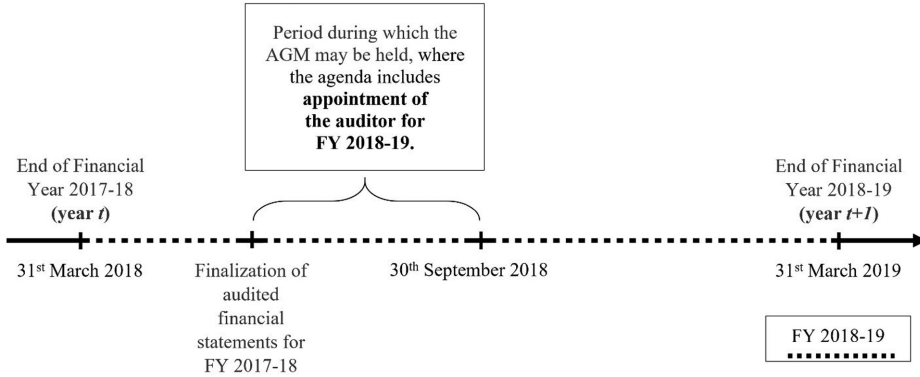
Such a dissent could also act as a disciplining mechanism, which acts as a check on future opportunistic behavior of the auditor and management. We argue that auditors and top management will be more sensitive to dissent by the sophisticated well-informed institutional shareholders on auditor reappointment, rather than dissent by retail shareholders who may be transient investors in the company, and that such dissent will act as a disciplining mechanism on subsequent auditor actions. Hence, auditors will try and provide a superior audit quality in the year subsequent to such dissent evidenced by a reduction in the magnitude of reported discretionary accruals in the year subsequent to such dissent. We employ abnormal accruals as our measure of audit quality since this measure has been widely used in prior audit quality research and since other metrics (such as, restatements or going-concern modified audit opinions) are not very prevalent in the Indian context. Formally stated:

**Hypothesis 3 (H3):** Institutional shareholder dissent on auditor reappointment resolutions will be negatively associated with change in magnitude of reported discretionary accruals in the year following the dissent.

## Data and Sample

We obtain the voting data for our analysis from the Bombay Stock Exchange (BSE). In September 2015, the Securities and Exchange Board of India (SEBI), the Indian capital markets regulator, notified a revised set of listing norms.<sup>7</sup> Pursuant to the notification, all listed companies in India are required to furnish shareholder voting results of all General Meetings to their respective stock exchanges. Shareholders can cast their vote at any meeting either remotely through e-voting or, personally or, through a proxy. The BSE website provides detailed data on voting results of all resolutions considered and voted for at a company's Annual General Meeting (AGM)/Extraordinary General Meeting (EGM) or court-convened meetings from the year 2016 onward for all companies listed on the exchange. The data are available at the resolution-level and include details on the type (whether AGM, EGM or court-convened) and date of the meeting, text of the resolution, and the details of votes cast in favor of or against the resolution by different types of shareholders.

Thus, in India, data about shareholder voting are available separately for both institutional and retail investors, making it possible to distinguish between the effects of institutional and retail shareholder voting on auditor ratification and subsequent auditor behavior. Extant studies on shareholder voting, using data from the United States or other countries, typically assume 100% voting by institutional shareholders and then back out the votes cast by retail shareholders (since data are available about the overall ownership pattern). Such assumptions are not needed when using Indian data.



**Figure 1.** Illustrative Timeline.

Note. AGM = annual general meeting; FY = financial year.

We collect data on shareholder voting on resolutions to ratify the auditor for the financial year, which is an *ordinary* resolution required to be approved by a simple majority.<sup>8</sup> For all the companies in our sample, shareholders hold voting rights based on the norm of one-share/one-vote. For each resolution, the following data are available by the type of shareholders, namely promoter, institutional and retail: Total number of shares, and thus votes, held; Total number of votes exercised or cast; Out of the total votes exercised, number of votes *for*, and *against*, the resolution. Abstentions from voting or withheld votes are not considered when deciding the outcome of the vote and, as such, are of little consequence.

We obtain financial data for the companies from the *Prowess* database of *Centre for Monitoring Indian Economy (CMIE)*. We then merge the voting data with financial data pertaining to the companies' most recently concluded financial year. In India, the Companies Act, 2013, mandates companies to follow an April-March financial year. Furthermore, as per the Act, the AGM pertaining to a financial year is required to be held within 6 months from the end of such financial year. To illustrate, the financial year (FY) 2017–2018 of a company begins on April 1, 2017, and ends on March 31, 2018. The AGM for the financial year ended on March 31, 2018, is required to be held within 6 months, that is, on or before September 30, 2018, which falls in FY 2018–2019. Therefore, the AGM for financial year  $t$  is held during the financial year  $t + 1$ . Figure 1 provides an illustration of the sequence of events from the end of financial year  $t$  to  $t + 1$ . Among other things, the agenda of the AGM pertaining to the financial year  $t$  includes the discussion and adoption of financial results of the financial year  $t$  and appointment or reappointment of the auditor for the financial year  $t + 1$ . Therefore, while the votes of the shareholders potentially reflect their perception of the results of the last concluded financial year  $t$ , they also influence the financial reporting by management and audit quality of the upcoming financial year  $t + 1$  ending after the AGM.

We start our analysis by screening the text of all resolutions and identify resolutions proposed for auditor appointment at the company's AGM. For clear identification of the differences in voting patterns of institutional and retail shareholders in our analyses, we require the sample to have both types of shareholders. We start with 3,450 firm-year observations of auditor appointment resolutions in non-financial firms with shareholding by both retail and institutional shareholders. We then drop 1,773 observations pertaining to the



**Table 1.** Sample Selection.

	Data restrictions	No. of firm-years
	Observations of auditor appointment resolutions with shareholding by retail and institutional shareholders	3,450
Less:	Appointment of a new auditor, i.e., not a reappointment	1,773
	Data on control variables not available	489
	Sample for analysis of shareholder dissent	1,188
Less:	Data of subsequent year not available	186
	Sample for analysis of consequences of shareholder dissent	1,002

appointment of a new auditor, as our analyses focus exclusively on auditor *reappointments*.<sup>9</sup> We lose an additional 489 observations due to lack of financial data or other control variables. As a result, the sample for analysis of shareholder dissent consists of 1,188 firm-year observations spanning years 2016–2020. For our analyses of the consequences of shareholder dissent, we require financial data of the subsequent year; such data are not available for 186 observations. Therefore, our analyses related to H2 and H3 use a sample of 1,002 firm-years. Table 1 summarizes our sample selection process.

Table 2 identifies and provides definitions of the variables used in our analysis. The descriptive statistics of our sample are presented in Table 3, Panel A. The mean (median) *NAS\_Fee\_Ratio* in our sample is 0.26 (0.14). Institutional shareholders have an average shareholding of 10.16% in our sample, as compared with 32.77% shares held by retail shareholders. The mean shareholding of institutional investors in our sample is relatively smaller and constitutes a minority ownership in the company when compared with the corresponding values in related studies, where institutions are majority owners. For example, the average institutional ownership is 57.96% in Lee and Souther (2020) and 75% in Chung and Lee (2020). On these grounds, our study provides an interesting context to study the impact of dissent by institutions on governance outcomes in the company despite their minority ownership, which otherwise restricts the extent of their influence on most affairs in the company requiring a majority vote.

The balance shares (57.07%) are held by promoters or inside shareholders of the firm. The high proportion of insider ownership often represents controlling ownership by a family or a business group, a characteristic of many Indian corporations (e.g., Gopalan et al., 2007; Hegde et al., 2020). In additional analyses, we examine the sensitivity of our results to family control or business group affiliation and do not find any evidence of significant variation in our results due to either of these factors. The data further reveal that institutional shareholders exercise 36.56% of their votes on an average on auditor reappointment resolutions as against 15.27% votes exercised by retail shareholders. The low percentage of votes exercised by retail shareholders suggests that a large proportion of them do not actively participate in the corporate decision on auditor ratification.

Shareholder participation rates do not vary greatly when we analyze the percentage of votes exercised by the shareholders on all resolutions at the annual meeting. Overall, 36% (24%) institutional (retail) shareholders vote on all resolutions on an average. This demonstrates that lower participation by retail shareholders is not limited to resolutions related to

**Table 2.** Variable Definitions.

Variable	Definition
<i>NAS_Fee_Ratio</i>	Ratio of fees for non-audit services to fees for audit services
<i>Inst_Holding_%</i>	Percentage of shares held by institutional shareholders on the day of voting
<i>Retail_Holding_%</i>	Percentage of shares held by retail shareholders on the day of voting
<i>Prom_Holding_%</i>	Percentage of shares held by promoter (inside) shareholders on the day of voting
<i>Inst_Dissent_D</i>	Dummy variable to indicate dissent by institutional shareholders against the resolution
<i>Retail_Dissent_D</i>	Dummy variable to indicate dissent by retail shareholders against the resolution
<i>Inst_Dissent_%</i> <i>[Ln_Inst_Dissent_%]</i>	Votes by institutional shareholders against the resolution, as a percentage of total shares (and thus, votes) held by them [log-transformed]. The log transformation is carried out by taking the natural logarithm of (1 + Dissent percentage).
<i>Retail_Dissent_%</i> <i>[Ln_Retail_Dissent_%]</i>	Votes by retail shareholders against the resolution, as a percentage of total shares (and thus, votes) held by them [log-transformed]. The log transformation is carried out by taking the natural logarithm of (1 + Dissent percentage).
<i>Avg_Inst_Dissent_%</i>	Average percentage of dissent votes cast by institutional shareholders for all other resolutions (except the resolution for auditor reappointment) at the meeting
<i>Avg_Retail_Dissent_%</i>	Average percentage of dissent votes cast by retail shareholders for all other resolutions (except the resolution for auditor reappointment) at the meeting
<i>Big4</i>	Dummy variable to indicate Big 4 auditor
<i>DA</i>	Signed value of discretionary accruals, calculated using modified Jones model based on Dechow et al. (1995)
<i>Auditor_Tenure</i>	Cumulative number of years the auditor has been auditing the client firm
<i>Size</i>	Natural log of total assets of the firm
<i>BAHR_OneYear</i>	Buy and hold return on the stock of the firm for 1 year preceding the date of voting
<i>Leverage</i>	Total liabilities scaled by total assets
<i>ROA</i>	Return on average assets during the year
$\Delta$ <i>NAS_Fee_Ratio</i>	Change in <i>NAS_Fee_Ratio</i> of the firm, from year $t$ to $t + 1$
$\Delta$ <i>Size</i>	Change in <i>Size</i> of the firm, from year $t$ to $t + 1$
$\Delta$ <i>Leverage</i>	Change in <i>Leverage</i> of the firm, from year $t$ to $t + 1$
$\Delta$ <i>ROA</i>	Change in <i>ROA</i> of the firm, from year $t$ to $t + 1$
$\Delta$ <i>DA</i>	Change in <i>DA</i> of the firm, from year $t$ to $t + 1$
$\Delta$ <i>MTB</i>	Change in market-to-book ratio of the firm, from year $t$ to $t + 1$
$\Delta$ <i>CFO</i>	Change in cash flow from operations of the firm, from year $t$ to $t + 1$
$\Delta$ <i>AuditFee</i>	Change in audit fees of the firm, from year $t$ to $t + 1$ , scaled by square root of total assets of the company in year $t$
<i>Finance_D</i>	Dummy variable which is 1 if number of o/s shares increased by at least 10% or long-term debt increased by at least 20% during the year $t + 1$ (Geiger & North, 2006)
<i>Acquisition_D</i>	Dummy variable which is 1 if the company engaged in an acquisition during the year $t + 1$
<i>Loss_D</i>	Dummy variable for loss in year $t$

**Table 3.**

Panel A: Descriptive Statistics (N = 1,188 Firm-Years).

Variables	M	SD	25%	50%	75%	N
NAS_Fee_Ratio	0.26	0.37	0.00	0.14	0.35	1,188
Inst_Holding_%	10.16	12.50	0.33	5.03	16.33	1,188
Retail_Holding_%	32.77	17.14	21.34	30.92	43.34	1,188
Prom_Holding_%	57.07	16.75	47.88	59.15	71.04	1,188
Inst_Dissent_D	0.14	0.35	—	—	—	1,188
Retail_Dissent_D	0.68	0.47	—	—	—	1,188
Inst_Dissent_% (if Inst_Dissent_D=1)	7.47	12.79	0.34	1.96	7.26	171
Retail_Dissent_% (if Retail_Dissent_D=1)	0.53	3.91	0.00	0.00	0.01	804
Avg_Inst_Dissent_%	1.82	5.25	0.00	0.00	0.88	1,188
Avg_Retail_Dissent_%	0.37	3.06	0.00	0.00	0.01	1,188
Big4	0.25	0.44	—	—	—	1,188
DA	0.00	0.14	-0.06	0.00	0.06	1,188
Auditor_Tenure	3.96	4.64	1.00	2.00	5.00	1,188
Size	8.57	1.76	7.43	8.58	9.67	1,188
BAHR_OneYear	12.87	84.77	-29.99	-1.46	33.86	1,188
Leverage	0.58	0.88	0.32	0.51	0.68	1,188
ROA	3.58	11.64	0.30	3.97	8.48	1,188
Δ NAS_Fee_Ratio	0.00	0.24	-0.04	0.00	0.04	1,002
Δ DA	0.02	0.12	-0.05	0.01	0.07	1,002

Panel B: Correlation Matrix (N = 1,188 Firm-Years)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)
Inst_Dissent_%	(1) <b>1.00</b>														
Retail_Dissent_%	(2) <b>.27</b>	<b>1.00</b>													
NAS_Fee_Ratio	(3) <b>.14</b>	<b>-.04</b>	<b>1.00</b>												
Inst_Holding_%	(4) <b>.11</b>	<b>-.04</b>	<b>.04</b>	<b>1.00</b>											
Retail_Holding_%	(5) <b>-.07</b>	<b>.02</b>	<b>-.10</b>	<b>-.40</b>	<b>1.00</b>										
Prom_Holding_%	(6) <b>-.01</b>	<b>.01</b>	<b>.07</b>	<b>-.34</b>	<b>-.73</b>	<b>1.00</b>									
Avg_Inst_Dissent_%	(7) <b>.38</b>	<b>.29</b>	<b>.00</b>	<b>.17</b>	<b>-.11</b>	<b>-.01</b>	<b>1.00</b>								
Avg_Retail_Dissent_%	(8) <b>.25</b>	<b>.93</b>	<b>-.04</b>	<b>-.05</b>	<b>.02</b>	<b>.01</b>	<b>.29</b>	<b>1.00</b>							
Big4	(9) <b>.06</b>	<b>-.05</b>	<b>.10</b>	<b>.37</b>	<b>-.31</b>	<b>.04</b>	<b>.13</b>	<b>-.04</b>	<b>1.00</b>						
DA	(10) <b>.02</b>	<b>.04</b>	<b>.00</b>	<b>.03</b>	<b>-.10</b>	<b>.08</b>	<b>.05</b>	<b>.03</b>	<b>.04</b>	<b>1.00</b>					
Auditor_Tenure	(11) <b>.02</b>	<b>-.05</b>	<b>.08</b>	<b>.00</b>	<b>.01</b>	<b>-.01</b>	<b>-.04</b>	<b>-.05</b>	<b>-.01</b>	<b>-.02</b>	<b>1.00</b>				
Size	(12) <b>.17</b>	<b>-.01</b>	<b>.14</b>	<b>.56</b>	<b>-.40</b>	<b>.00</b>	<b>.28</b>	<b>-.02</b>	<b>.40</b>	<b>.00</b>	<b>-.01</b>	<b>1.00</b>			
BAHR_OneYear	(13) <b>-.02</b>	<b>-.03</b>	<b>.01</b>	<b>-.07</b>	<b>.02</b>	<b>.03</b>	<b>-.05</b>	<b>-.02</b>	<b>-.01</b>	<b>.07</b>	<b>.04</b>	<b>-.08</b>	<b>1.00</b>		
Leverage	(14) <b>-.02</b>	<b>.01</b>	<b>-.04</b>	<b>-.04</b>	<b>.09</b>	<b>-.06</b>	<b>-.03</b>	<b>.01</b>	<b>-.09</b>	<b>-.11</b>	<b>-.02</b>	<b>-.08</b>	<b>.02</b>	<b>1.00</b>	
ROA	(15) <b>-.02</b>	<b>-.07</b>	<b>.07</b>	<b>.12</b>	<b>-.20</b>	<b>.12</b>	<b>-.01</b>	<b>-.08</b>	<b>.19</b>	<b>.45</b>	<b>.00</b>	<b>.12</b>	<b>.17</b>	<b>-.17</b>	<b>1.00</b>

Note. The table presents descriptive statistics for the analysis sample. All variables are defined in Table 2. The values in the matrix represent Pearson's correlation coefficients for variables in the analysis sample. The bold faced correlation coefficients are significant at  $p < .05$ .

auditor ratification. This reinforces the idea that managers and auditors would be much more attentive to dissent votes by institutional shareholders rather than retail shareholders.

Of the 1,188 observations in the sample, dissent by institutional shareholders is observed in 171 observations (14% of the sample). The corresponding number for dissent by retail

shareholders is 804 observations (68%). Within the subsample in which dissent is observed, the mean (median) dissent by institutional shareholders is 7.47% (1.96%) and that by retail shareholders is 0.53% (0.01%). While the average shareholder dissent in our sample is relatively low, we note that even relatively small shareholder dissent could discipline managerial actions (Dao et al., 2012; Grundfest, 1992; Tanyi et al., 2020). For example, former SEC Commissioner Grundfest (1992) suggests that reputational concerns may prompt directors and auditors to respond to even small shareholder dissent. Similarly, even relatively small shareholder dissent is associated with factors like better alignment of CEO turnover and executive compensation with firm performance (Del Guercio et al., 2008; Ertimur et al., 2013), increased director turnover (Brochet & Srinivasan, 2014), and removal of poison pills and classified boards (Cai et al., 2009).

The presence of a large number of zero-dissent observations in the case of institutional shareholders demonstrates the skewness in their voting pattern. We address this skewness by employing a two-part hurdle model (Cragg, 1971) in our analyses, which is discussed in detail in the next section. About 25% of observations in the sample are audited by a Big 4 auditor, and the average auditor tenure in the sample is about 4 years. The correlation matrix for the variables is provided in Table 3, Panel B.

## NAS and Shareholder Dissent

### Research Design—H1

An examination of the voting pattern of institutional shareholders in our sample reveals a high proportion of instances wherein they express no dissent on the resolution, which are corner solution outcomes. The distribution of data on dissent votes by institutional shareholders is therefore zero-inflated, as more than half of the observations have no dissent by institutional shareholders. The subset of data with non-zero dissent values (i.e., where institutional shareholders express at least *some* dissent) follows a continuous distribution. Overall, this represents a two-step sequential decision process on the part of institutional investors involving the *choice* to dissent and the *magnitude* of dissent.

Therefore, we model these choices using a two-part hurdle model based on Cragg (1971).<sup>10,11</sup> The Cragg (1971) hurdle model involves the estimation of two separate equations. First, we estimate a probit model (Equation 1) on the full sample where the dependent variable is an indicator variable for dissent expressed by institutional or retail shareholders. In the second part, we estimate a truncated ordinary least squares regression model (Equation 2) on the subsample of firm-years with positive dissent expressed by institutional or retail shareholders, respectively, in separate regressions. The dependent variable represents the magnitude of dissent votes by institutional or retail shareholders, respectively. In the second stage regressions, we use log-transformed measures of the percent of dissent votes, as the raw measures are skewed. The independent variable of interest is *NAS\_Fee\_Ratio* in both the equations, which represents the ratio of NAS fees to audit fees.

$$\begin{aligned}
 & Prob(Dissent\_Inst\_D_{it} = 1) [or Prob(Dissent\_Retail\_D_{it} = 1)] \\
 & = F(\beta_0 + \beta_1 NAS\_Fee\_Ratio_{it} + \beta_2 Inst\_Holding\_ \%_{it} [or Retail\_Holding\_ \%_{it}] \\
 & + \beta_3 Prom\_Holding\_ \%_{it} + \beta_4 Avg\_Inst\_Dissent\_ \%_{it} [or Avg\_Retail\_Dissent\_ \%_{it}] \quad (1) \\
 & \beta_5 Big4_{it} + \beta_6 DA_{it} + \beta_7 Auditor\_Tenure_{it} + \beta_8 Size_{it} + \beta_9 Bahr\_OneYear_{it} \\
 & + \beta_{10} Leverage + \beta_{11} ROA_{it} + D.Year + D.Ind + \epsilon_{it}).
 \end{aligned}$$

$$\begin{aligned}
& Ln\_Inst\_Dissent\_ \%_{it} [or Ln\_Retail\_Dissent\_ \%_{it}] \\
& = \beta_0 + \beta_1 NAS\_Fee\_Ratio_{it} + \beta_2 Inst\_Holding\_ \%_{it} [or Retail\_Holding\_ \%_{it}] \\
& + \beta_3 Prom\_Holding\_ \%_{it} + \beta_4 Avg\_Inst\_Dissent\_ \%_{it} [or Avg\_Retail\_Dissent\_ \%_{it}] \quad (2) \\
& + \beta_5 Big4_{it} + \beta_6 DA_{it} + \beta_7 Auditor\_Tenure_{it} + \beta_8 Size_{it} + \beta_9 BAHR\_OneYear_{it} \\
& + \beta_{10} Leverage + \beta_{11} ROA_{it} + D.Year + D.Ind + \epsilon_{it}.
\end{aligned}$$

The subscripts (omitted hereafter for brevity)  $i$  and  $t$  denote the company and the financial year, respectively. The proportion of stake held by a particular group of shareholders might influence the magnitude of dissent expressed by them on resolutions proposed at the AGM. A higher stake implies a higher exposure to potential risks and rewards of any decision made at the meeting. Therefore, the stakeholders are more likely to make an informed decision when they hold a substantial stake than when they hold only a nominal stake. We control for the percentage of shares held by both institutional and retail shareholders through *Inst\_Holding\_ %* and *Retail\_Holding\_ %*, respectively.

A salient feature of many listed firms in India is the controlling ownership by founding families, or promoters (Narayanaswamy et al., 2012). The extent of shareholding by promoters might influence the voting patterns of external shareholders, so we control for the percentage shareholding by promoters (*Prom\_Holding\_ %*). Furthermore, shareholders generally disgruntled with the company due to potential governance flaws or poor performance may campaign to vote against *all* resolutions proposed by the management, a phenomenon known as “Just vote no” (discussed by Grundfest, 1992; see also, Del Guercio et al., 2008). Hence, we control for the average dissent expressed by institutions or retail shareholders, respectively, for all other resolutions proposed at the shareholder meeting *except* the resolution for auditor appointment (*Avg\_Inst\_Dissent\_ %* and *Avg\_Retail\_Dissent\_ %*).

The next set of controls account for audit-related characteristics such as type of auditor (*Big4*), and audit quality, which is proxied by the magnitude of signed discretionary accruals (*DA*) as these characteristics are likely to influence shareholders’ perception of auditor’s competence.<sup>12</sup> Furthermore, we include a control for auditor tenure (*Auditor\_Tenure*) as it has been shown that disclosure of auditor tenure influences auditor ratification votes (Dunn et al., 2021). Firm characteristics such as size, stock returns, leverage, and profitability are controlled for through the inclusion of *Size*, *BAHR\_OneYear*, *Leverage*, and *ROA* in our model. We control for unobserved year and time-invariant industry characteristics by including their respective dummies. All control variables pertain to financial year  $t$ .<sup>13,14</sup>

## Results—H1

We first conduct univariate tests for differences in *NAS\_Fee\_Ratio* between dissent and non-dissent samples for both institutional and retail shareholders. The results of the univariate tests are presented in Table 4, Panel A. The mean and median values of *NAS\_Fee\_Ratio* for the institutional dissent sample (i.e., *Dissent\_Inst\_D* = 1) are significantly higher than those in the sample where no institutional dissent is observed. The differences of means and medians, evaluated based on a  $t$  test and Wilcoxon test, respectively, are significant at the 1% level. However, the comparison of mean and median values of *NAS\_Fee\_Ratio* on the basis of retail shareholder dissent reveals no consistent significant differences between the two groups.

**Table 4.**

Panel A: Univariate Analysis of Differences in *NAS\_Fee\_Ratio* Between Samples With and Without Dissent by Institutional and Retail Shareholders Respectively

		Whether non-zero <i>institutional</i> dissent present?			
		Yes (1)	No (2)	Difference (1)–(2)	t/z-statistic
<i>NAS_Fee_Ratio</i>	M	0.400	0.233	0.166	5.561***
	Median	0.259	0.232	0.027	6.246***
	N	171	1,017		
		Whether non-zero <i>retail</i> dissent present?			
		Yes (1)	No (2)	Difference (1)–(2)	t/z-statistic
<i>NAS_Fee_Ratio</i>	M	0.259	0.253	0.006	0.282
	Median	0.143	0.119	0.024	2.030**
	N	804	384		

Note. The differences of means and medians are evaluated based on t test and Wilcoxon test, respectively.

(continued)

The results of multivariate two-part hurdle regressions (Equations 1 & 2) are presented in Panel B of Table 4. Columns (1) and (2) present the results for analysis of institutional dissent whereas columns (3) and (4) present the same for retail shareholders' dissent. Column (1) shows the results of estimation of the first-part or *choice* model, which is estimated as a probit regression on the full sample. The results indicate that the likelihood of dissent by institutional shareholders is significantly positively associated with *NAS\_Fee\_Ratio*. Furthermore, the results of the truncated regression in column (2) indicate that the level of *NAS\_Fee\_Ratio* significantly impacts the magnitude of institutional dissent within the dissent subsample. Both the associations are significant at the 1% level, suggesting that *NAS\_Fee\_Ratio* significantly influences both the choice of institutional shareholders to express dissent on reappointment of the auditor and the magnitude of such dissent. Our results are also economically meaningful. The coefficients in column (2) suggest that percentage votes against auditor reappointment by dissenting institutions rise by about 11.85% for every increase in NAS ratio by 0.10% or 10% of the audit fees. Column (1) further indicates that institutional shareholders are more likely to express dissent in bigger firms and in firms where they have a higher shareholding. The coefficients of *NAS\_Fee\_Ratio* are statistically significant even after controlling for the average level of dissent of the shareholders for other proposed resolutions, implying that the dissent of institutional shareholders is particularly critical in the case of auditor ratification resolutions.

Unlike the case of institutional dissent, the likelihood of dissent by retail shareholders on auditor reappointment is not positively associated with the NAS fee variable, measured by *NAS\_Fee\_Ratio* (column 3). Furthermore, the magnitude of retail dissent, measured by *Ln\_Retail\_Dissent\_%*, does not have a significant association with *NAS\_Fee\_Ratio* in the second-part truncated regression (column 4). Results of probit regression of the likelihood of retail dissent in column (3) further document that a firms' size positively and

**Table 4.** (continued)

Panel B: Shareholder Dissent on Auditor's Reappointment

Dependent variable	Institutional shareholders' dissent % (1-2)		Retail shareholders' dissent % (3-4)	
	1st stage (choice)	2nd stage (magnitude)	1st stage (choice)	2nd stage (magnitude)
	Probit regression (1)	Truncated regression (2)	Probit regression (3)	Truncated regression (4)
	<i>Inst_Dissent_D</i>	<i>Ln_Inst_Dissent_%</i>	<i>Retail_Dissent_D</i>	<i>Ln_Retail_Dissent_%</i>
<i>NAS_Fee_Ratio</i>	0.516*** [3.324]	1.185*** [3.547]	-0.090 [-0.796]	0.410 [1.481]
<i>Inst_Holding_%</i>	0.022*** [3.471]	-0.047*** [-2.686]		
<i>Retail_Holding_%</i>			-0.001 [-0.024]	-0.009 [-0.949]
<i>Prom_Holding_%</i>	0.004 [0.793]	-0.022* [-1.752]	-0.010** [-2.300]	-0.010 [-1.109]
<i>Avg_Inst_Dissent_%</i>	0.038*** [4.530]	0.046* [1.799]		
<i>Avg_Retail_Dissent_%</i>			0.109*** [2.693]	0.322*** [12.093]
<i>Big4</i>	0.027 [0.213]	-0.436 [-1.304]	0.210* [1.884]	-0.232 [-0.978]
<i>DA</i>	0.470 [0.801]	-2.667 [-1.282]	0.538 [1.624]	0.649 [0.833]
<i>Auditor_Tenure</i>	0.001 [0.045]	0.023 [0.683]	0.004 [0.373]	-0.002 [-0.075]
<i>Size</i>	0.528*** [8.980]	0.007 [0.054]	0.265*** [8.237]	0.002 [0.030]
<i>BAHR_OneYear</i>	0.000 [0.041]	0.000 [0.065]	-0.001 [-0.719]	-0.001 [-1.002]
<i>Leverage</i>	-0.532* [-1.795]	-0.628 [-0.675]	0.136 [1.463]	0.126 [1.343]
<i>ROA</i>	0.019** [2.274]	-0.001 [-0.042]	-0.008* [-1.825]	-0.009 [-0.924]
Constant	-6.749*** [-10.216]	3.020* [1.749]	-1.287** [-2.067]	-5.063*** [-3.763]
Industry dummies	Yes	Yes	Yes	Yes
Year dummies	Yes	Yes	Yes	Yes
No. of observations	1,188	171	1,188	804
Pseudo R <sup>2</sup>	.413	—	.133	—
Model chi-squared	403.852***	—	199.173***	—
Adj. R <sup>2</sup>	—	.161	—	.178
F-stat	—	2.419***	—	8.556***

Chow test of equality of coefficients of *NAS\_Fee\_Ratio* in models explaining dissent by institutional and retail shareholders, respectively:

$\beta_i(\text{Probit: } Inst\_Dissent) = \beta_i(\text{Probit: } Retail\_Dissent)$ (Columns 1 and 3)	Chi-squared = 11.70 p value = .00
$\beta_i(\text{OLS: } Inst\_Dissent) = \beta_i(\text{OLS: } Retail\_Dissent)$ (Columns 2 and 4)	Chi-squared = 17.80 p value = .00

Note. The table presents results of regressions based on the two-part hurdle model (Cragg, 1971). Columns (1) and (3) present results of probit regressions, where the dependent variables are indicator variables for presence of institutional and retail dissent, respectively. Columns (2) and (4) present results of truncated OLS regressions, where the dependent variables are log-transformed versions of *Inst\_Dissent\_%* (*Ln\_Inst\_Dissent\_%*) and *Retail\_Dissent\_%* (*Ln\_Retail\_Dissent\_%*), respectively. All variables are defined in Table 2. Values in square brackets represent z-stats. OLS = ordinary least squares.

\*, \*\*, and \*\*\* denote significance at the 10%, 5%, and 1% levels, respectively.

significantly affects the probability of retail shareholder dissent. Furthermore, *ROA* is negatively associated with the likelihood of retail shareholder dissent, although the relationship is of marginal significance.

We then conduct Chow tests for equality of coefficients of *NAS\_Fee\_Ratio* between our regression estimates for institutional dissent and retail dissent. The Chow tests reject the null hypotheses that the coefficients of *NAS\_Fee\_Ratio* ( $\beta_1$ ) are equal for models explaining institutional shareholders' dissent and those explaining retail shareholders' dissent, in the case of both probit and truncated regression models. Collectively, our findings support the view that institutional shareholders are more active participants than retail shareholders in corporate decision making and express their dissent on auditor's reappointment when the perceived objectivity and independence of the auditor is weakened by provision of higher NAS. These results support H1.

## Institutional Dissent and Subsequent NAS Purchase

### Research Design—H2

We now examine whether the auditor and management of the company take any steps in response to the shareholder dissent for auditor ratification. For these tests, we examine changes in factors that are indicative of auditor independence and audit quality in the subsequent year in response to the dissent. To formally test H2, we analyze the association between the change in *NAS\_Fee\_Ratio* from year  $t$  to year  $t + 1$ , denoted by  $\Delta$  *NAS\_Fee\_Ratio*, and the magnitude of institutional dissent faced while reappointing the auditor for year  $t + 1$ . We employ the following regression model to conduct this test.

$$\begin{aligned} & \Delta \text{NAS\_Fee\_Ratio}_{it,t+1} \\ & = \beta_0 + \beta_1 \text{Shareholder\_Dissent\_D}_{it} \text{ [or Ln\_Shareholder\_Dissent\_}\%_{it}] \\ & \quad + \beta_2 \text{NAS\_Fee\_Ratio}_{it} + \beta_3 \text{Big4}_{it} + \beta_4 \text{Finance\_D}_{it,t+1} + \beta_5 \text{Acquisition\_D}_{it,t+1} \quad (3) \\ & \quad + \beta_6 \Delta \text{Size}_{it,t+1} + \beta_7 \Delta \text{Leverage}_{it,t+1} + \beta_8 \text{ROA}_{it,t+1} + \beta_9 \Delta \text{DA}_{it,t+1} \\ & \quad + D.\text{Year} + D.\text{Ind} + \epsilon_{it}. \end{aligned}$$

The above equation is first estimated on the full sample for which data for subsequent year are available. The variables of interest therein are indicator variables for institutional and retail shareholder dissent, denoted by *Inst\_Dissent\_D* and *Retail\_Dissent\_D*, respectively. Then, the equation is estimated separately on the subsamples in which positive dissent by either type of shareholders (or both) is observed, where the variables of interest are *Ln\_Inst\_Dissent\_%* or *Ln\_Retail\_Dissent\_%* (or both), to examine the effect of magnitude of dissent votes on the dependent variable. Thus, in our analyses, we separately account for the differential impact of the presence of shareholder dissent and the magnitude of shareholder dissent, the latter being examined only in subsamples where such dissent is present.

In these estimations, a negative and significant coefficient for institutional shareholder dissent would indicate a negative relationship between institutional dissent on auditor reappointment at the AGM (taking place during year  $t + 1$ ) and the change in *NAS\_Fee\_Ratio* in the year  $t + 1$ . We control for the level of *NAS\_Fee\_Ratio* in year  $t$  to account for any level-effects on subsequent change in the ratio of NAS fees. Next, we control for auditor type (*Big4*) to control for any differential responses to shareholder dissent by auditor type. A company may require a higher amount of NAS when it raises additional finance. To



**Table 5.**

Panel A: Univariate Analysis of Differences in  $\Delta$  *NAS\_Fee\_Ratio* (Change in *NAS\_Fee\_Ratio* of the Firm From Year *t* to *t* + 1) Between Samples With and Without Dissent by Institutional and Retail Shareholders, Respectively

		Whether non-zero <i>institutional</i> dissent present?			Difference (1)–(2)	t/z-statistic
		Yes (1)	No (2)			
$\Delta$ <i>NAS_Fee_Ratio</i>	<i>M</i>	–0.088	0.012	–0.101	4.707***	
	Median	–0.000	0.000	–0.000	1.682*	
	<i>N</i>	140	862			
		Whether non-zero <i>retail</i> dissent present?			Difference (1)–(2)	t/z-statistic
		Yes (1)	No (2)			
$\Delta$ <i>NAS_Fee_Ratio</i>	<i>M</i>	0.009	–0.023	0.031	1.989**	
	Median	0.000	0.000	0.000	2.391**	
	<i>N</i>	665	337			

Note. The differences of means and medians are evaluated based on *t* test and Wilcoxon test, respectively. \*, \*\*, and \*\*\* denote significance at the 10%, 5%, and 1% levels, respectively.

(continued)

control for the impact of issuing incremental capital or debt, we include *Finance\_D*, which equals one if the outstanding shares or debt of the company increase by 10% or 20%, respectively (Geiger & North, 2006). Similarly, firms that have a merger, acquisition, or restructuring activity within the sample period may purchase a higher amount of NAS. Hence, we control for this factor by including a dummy variable *Acquisition\_D*.

We control for changes in company characteristics such as  $\Delta$  *Size*,  $\Delta$  *Leverage*, and  $\Delta$  *ROA* of the company from year *t* to year *t* + 1, to account for any likely impact of these factors on the quantum of NAS availed by the company or provided by the auditor. In addition, we also control for any variation in audit quality between years *t* and *t* + 1, proxied by change in the level of discretionary accruals ( $\Delta$  *DA*), to account for any correlation between improved audit quality and reduction in NAS. The model further includes year and industry dummies, to account for unobserved time and industry-level heterogeneity.

**Results—H2**

The results of our analyses to test H2 are presented in Table 5. Panel A shows the results of univariate tests of differences of mean and median values of  $\Delta$  *NAS\_Fee\_Ratio* between dissent and non-dissent subsamples. In the subsample where institutional dissent is observed, there is a mean reduction in NAS fee ratio in the subsequent year, as compared with a mean increase in the non-dissent sample. The difference is significant at the 1% level. However, a similar pattern of reduction in *NAS\_Fee\_Ratio* is not observed in the subsample with dissent by retail shareholders.

**Table 5.** (continued)

## Panel B: Consequences of Shareholder Dissent—Reduction in NAS Fee Ratio

Dependent variable	(1) $\Delta \text{NAS\_Fee\_Ratio}$	(2) $\Delta \text{NAS\_Fee\_Ratio}$	(3) $\Delta \text{NAS\_Fee\_Ratio}$	(4) $\Delta \text{NAS\_Fee\_Ratio}$
<i>Inst_Dissent_D</i>	−0.069*** [−3.206]			
<i>Retail_Dissent_D</i>	0.040*** [2.661]			
<i>Ln_Inst_Dissent_%</i>		−0.044*** [−2.646]		−0.052*** [−2.834]
<i>Ln_Retail_Dissent_%</i>			−0.006 [−0.267]	−0.028 [−0.600]
<i>NAS_Fee_Ratio</i>	−0.231*** [−11.252]	−0.399*** [−10.829]	−0.257*** [−9.704]	−0.358*** [−8.721]
<i>Big4</i>	0.032* [1.878]	0.025 [0.651]	0.028 [1.401]	−0.020 [−0.481]
<i>Finance_D</i>	−0.011 [−0.719]	−0.045 [−1.141]	−0.005 [−0.282]	−0.041 [−0.941]
<i>Acquisition_D</i>	0.015 [0.729]	−0.017 [−0.404]	0.018 [0.719]	0.008 [0.178]
$\Delta$ Size	0.090** [2.272]	−0.081 [−0.844]	0.104** [2.083]	−0.115 [−1.130]
$\Delta$ Leverage	−0.098** [−2.183]	−0.162 [−0.574]	−0.108* [−1.897]	0.032 [0.104]
$\Delta$ ROA	−0.002** [−2.105]	−0.005 [−1.484]	−0.002* [−1.936]	−0.004 [−1.059]
$\Delta$ DA	0.039 [0.840]	0.101 [0.601]	0.052 [0.856]	−0.002 [−0.011]
Constant	0.065* [1.702]	0.086 [0.774]	0.083* [1.730]	0.092 [0.815]
Industry dummies	Yes	Yes	Yes	Yes
Year dummies	Yes	Yes	Yes	Yes
No. of observations	1,002	140	665	120
Adj. $R^2$	.146	.585	.130	.519
F-stat	9.17***	11.314***	5.945***	7.411***

Note. The table presents results of ordinary least squares regression where the dependent variable is change in *NAS\_Fee\_Ratio* between year  $t$  and  $t + 1$ . All variables are defined in Table 2. Values in square brackets represent  $t$ -stats.

\*, \*\* and \*\*\* denote significance at the 10%, 5%, and 1% levels, respectively.

The univariate results are further supported by the results of our multivariate tests, which are presented in Panel B of Table 5. Column (1) shows that the change in NAS fee ratio in the subsequent year ( $\Delta \text{NAS\_Fee\_Ratio}$ ) is significantly negatively associated with the action of dissent by institutional shareholders. However,  $\Delta \text{NAS\_Fee\_Ratio}$  is not negatively associated with the dissent action of retail shareholders. Further tests indicate that in the subsample with non-zero institutional dissent, the magnitude of dissent votes also bears a negative relationship with the magnitude of  $\Delta \text{NAS\_Fee\_Ratio}$ , implying that a higher dissent is associated with a sharper reduction in the purchase of NAS (column 2). A similar relationship between  $\Delta \text{NAS\_Fee\_Ratio}$  and *Ln\_Inst\_Dissent\_%* is observed in the

subsample where dissent by both institutional and retail shareholders is present (column 4). The coefficients of  $Ln\_Inst\_Dissent\_%$  are negative and statistically significant at the 1% level in both cases. The estimates indicate that an increase of about 5% in dissent percentage of institutions is associated with a reduction in  $\Delta NAS\_Fee\_Ratio$  in the range of 0.22 to 0.26 or approximately one standard deviation, which implies that our results are economically significant. In contrast with institutional dissent, dissent by retail shareholders, that is,  $Ln\_Retail\_Dissent\_%$  does not negatively and significantly influence the change in NAS fee ratio. The coefficient of  $NAS\_Fee\_Ratio$ , which accounts for the effect of level of NAS fee ratio in the previous year (year  $t$ ), is negative and significant at the 1% level, indicating mean reversion in the ratio of NAS fees.

Overall, our results indicate that both the action of dissent and the magnitude of dissent votes by institutional shareholders on auditor ratification for financial year  $t + 1$  are negatively associated with NAS purchases in that year. The lack of a negative and significant relationship between the action or magnitude of retail shareholders' dissent and  $\Delta NAS\_Fee\_Ratio$  provides support to our hypothesis that dissent by retail shareholders does not play an active role in influencing the purchase of NAS by the company.

The AGM where the resolution for reappointment of the auditor is proposed is required to be held before the end of the second quarter of the financial year as per the prevailing regulation. Therefore, after the conclusion of the meeting, both the management and the auditor of the company have adequate time before the end of the financial year to renegotiate the purchase and provision of NAS to respond to any institutional shareholder dissent to the appointment of the auditor. Hence, the management and auditor negotiate a lower level of NAS services and associated fees to signal increased independence and objectivity of the auditor at the end of the financial year  $t + 1$ . These results support H2.

## Institutional Dissent and Subsequent Audit Quality

### Research Design (H3)

In our third hypothesis, we test whether the dissent by institutional shareholders is associated with improvements in audit quality. Prior research suggests that external stakeholders of a company are more likely to be concerned about income-increasing abnormal accruals (Desai & Gerard, 2013; Heninger, 2001). Therefore, we analyze changes in signed discretionary accruals in the subsequent year in response to dissent faced on auditor reappointment. The regression equation for this test is presented below, where the dependent variable measures the change in reported discretionary accruals  $DA$ , from year  $t$  to year  $t + 1$ .

$$\begin{aligned} \Delta DA_{it,t+1} &= \beta_0 + \beta_1 \text{Shareholder\_Dissent\_}D_{it} \text{ [or } Ln\_Shareholder\_Dissent\_ \%_{it}] \\ &+ \beta_2 \text{Big4}_{it} + \beta_3 DA_{it} + \beta_4 \text{Loss\_}D_{it} + \beta_5 \text{Finance\_}D_{it,t+1} + \beta_6 \text{Acquisition\_}D_{it,t+1} \quad (4) \\ &+ \beta_7 \Delta \text{AuditFee}_{it,t+1} + \beta_8 \Delta \text{Size}_{it,t+1} + \beta_9 \Delta \text{CFO}_{it,t+1} + \beta_{10} \Delta \text{ROA}_{it,t+1} \\ &+ \beta_{11} \Delta \text{Leverage}_{it,t+1} + \beta_{12} \Delta \text{MTB}_{it,t+1} + D.Year + D.Ind + \epsilon_{it}. \end{aligned}$$

The control variables in equation (4) include  $Big4$  to account for the type of auditor. We include the level of  $DA$  in the previous year (year  $t$ ), as well as an indicator variable  $Loss\_D$  for loss-making firms as control variables, as these may influence the magnitude of change in  $DA$  in the year  $t + 1$ .  $Finance\_D$  controls for the propensity of firms to manage

**Table 6.**

Panel A: Univariate Analysis of Differences in  $\Delta DA$  (Change in  $DA$  of the Firm From Year  $t$  to  $t + 1$ ) Between Samples With and Without Dissent by Institutional and Retail Shareholders, Respectively

		Whether non-zero <i>institutional</i> dissent present?		Difference (1)–(2)	t/z-statistic
		Yes (1)	No (2)		
$\Delta DA$	M	–0.030	0.030	–0.059	–6.253***
	Median	–0.017	0.012	–0.030	–5.511***
	N	140	862		
		Whether non-zero <i>retail</i> dissent present?		Difference (1)–(2)	t/z-statistic
		Yes (1)	No (2)		
$\Delta DA$	M	0.013	0.034	–0.022	–2.731***
	Median	0.002	0.016	–0.013	–2.973***
	N	665	337		

Note. The differences of means and medians are evaluated based on t test and Wilcoxon test, respectively.

\*, \*\* and \*\*\* denote significance at the 10%, 5%, and 1% levels, respectively.

(continued)

earnings around fund-raising activities (see, e.g., DuCharme et al., 2004; Liu et al., 2010; Rangan, 1998). Similarly, *Acquisition\_D* controls for potential earnings management around corporate acquisition or restructuring activities (e.g., Erickson & Wang, 1999).  $\Delta$  *AuditFee* controls for change in auditor's efforts, which could influence variation in audit quality during the year. Furthermore, we control for changes in various firm characteristics and performance indicators such as size, operating cash flows, profitability, leverage, and market-to-book ratio.

### Results (H3)

Table 6 presents the results for test of H3. Univariate comparisons presented in Panel A of Table 6 report that discretionary accruals in the subsequent year are significantly reduced in the firm-years, which face institutional dissent on auditor reappointment, when compared with firm-years which do not face such dissent. On the contrary, such reduction in the mean and median values of  $DA$  is not observed in the sample with retail shareholders' dissent. The conclusions drawn from the univariate tests are consistent with hypothesis H3.

Table 6 Panel B reports the results of multivariate tests for H3. The variables of interest in column (1) are *Inst\_Dissent\_D* and *Retail\_Dissent\_D* whereas those in column (2) to (4) are *Ln\_Inst\_Dissent\_%* and *Ln\_Retail\_Dissent\_%*, respectively. The coefficient of *Inst\_Dissent\_D* confirms the presence of a significant negative relationship between  $\Delta DA$  and dissent by institutional shareholders. We do not observe such a relationship for retail shareholders.

As shown in columns (2) and (4), the results report a negative association between the magnitude of institutional dissent and change in discretionary accruals ( $\Delta DA$ ). The coefficient of *Ln\_Inst\_Dissent\_%* is negative and significant at the 1% level in both columns (2)

**Table 6.** (continued)

Panel B: Consequences of Shareholder Dissent—Reduction in Discretionary Accruals

Dependent variable	(1) $\Delta DA$	(2) $\Delta DA$	(3) $\Delta DA$	(4) $\Delta DA$
<i>Inst_Dissent_D</i>	−0.021*** [−2.702]			
<i>Retail_Dissent_D</i>	−0.009 [−1.443]			
<i>Ln_Inst_Dissent_%</i>		−0.012** [−2.383]		−0.014*** [−2.677]
<i>Ln_Retail_Dissent_%</i>			0.010 [0.858]	−0.003 [−0.089]
<i>Big4</i>	−0.002 [−0.361]	0.009 [0.823]	−0.012 [−1.582]	0.001 [0.125]
<i>DA</i>	−0.572*** [−22.768]	−0.650*** [−10.629]	−0.584*** [−17.080]	−0.580*** [−8.771]
<i>Loss_D</i>	−0.006 [−0.851]	−0.003 [−0.146]	−0.009 [−1.057]	0.011 [0.474]
<i>Finance_D</i>	0.034*** [5.795]	0.015 [1.285]	0.037*** [5.184]	0.018 [1.488]
<i>Acquisition_D</i>	−0.013 [−1.638]	−0.017 [−1.490]	−0.014 [−1.590]	−0.021* [−1.768]
$\Delta$ AuditFee	0.001 [0.215]	−0.007 [−1.136]	0.001 [0.315]	−0.007 [−1.159]
$\Delta$ Size	0.091*** [5.409]	−0.051* [−1.867]	0.081*** [4.031]	−0.055* [−1.976]
$\Delta$ CFO	−0.001*** [−5.608]	−0.001*** [−3.839]	−0.001*** [−4.760]	−0.001*** [−3.017]
$\Delta$ ROA	0.001*** [2.602]	0.004*** [2.781]	0.001*** [3.082]	0.004** [2.571]
$\Delta$ Leverage	−0.043** [−2.139]	−0.040 [−0.529]	−0.010 [−0.407]	−0.041 [−0.524]
$\Delta$ MTB	0.008** [2.309]	−0.008 [−1.544]	0.006 [1.462]	−0.006 [−1.227]
Constant	0.015 [1.000]	0.037 [1.160]	−0.004 [−0.215]	0.035 [1.102]
Industry dummies	Yes	Yes	Yes	Yes
Year dummies	Yes	Yes	Yes	Yes
No. of observations	1,002	140	665	120
Adj. R <sup>2</sup>	.471	.535	.403	.465
F-stat	38.157***	9.953***	21.313***	6.771***

Note. The table presents results of ordinary least squares regression where the dependent variable is change in signed discretionary accruals (DA) between year  $t$  and  $t + 1$ . All variables are defined in Table 2. Values in square brackets represent  $t$ -stats.

\*, \*\* and \*\*\* denote significance at the 10%, 5%, and 1% levels, respectively.

and (4), thus implying that a higher percentage of institutional dissent votes leads to greater reduction in discretionary accruals. These results are also economically significant as evidenced by the fact that the estimated coefficients suggest that an increase of about 10% in institutional dissent percentage is related to a reduction in  $\Delta DA$  in the range of 0.12 to

0.14 which is approximately one standard deviation of  $\Delta DA$ . In contrast,  $\Delta DA$  does not show a statistically significant relationship with either *Retail\_Dissent\_D* or *Ln\_Retail\_Dissent\_%* in any of our specifications, which indicates that dissent by retail shareholders is not associated with changes in accruals. Consistent with expectations, our results indicate that discretionary accruals are mean reverting. The coefficients of *Finance\_D* in columns (1) and (3) also indicate that abnormal accruals increase significantly in case the firm engages in a debt or equity financing activity during the year. Furthermore,  $\Delta DA$  is negatively associated with change in cash flow from operations ( $\Delta CFO$ ) and positively associated with change in return on assets ( $\Delta ROA$ ).

These results support the view that auditors and management are sensitive to dissent by institutional—but not retail—shareholders and report financial statements with improved audit quality in the subsequent year. These results support our hypothesis by providing evidence of improvement in audit quality, a signal of increased objectivity and conservatism by the auditor, in response to institutional—but not retail—dissent for auditor ratification.

## Conclusion

In this study, we examine differences in the determinants and consequences of shareholder voting on auditor reappointment based on the types of shareholder votes. Since India (unlike other countries, such as the United States) requires companies to provide details about shareholder voting by type of shareholders, we are able to directly test for differences between the voting of institutional and retail shareholders.

Shareholder voting on auditor ratification is an important element in the framework of corporate governance. Consistent with prior research which provides evidence of superior monitoring and governance capabilities of institutional shareholders in comparison to non-institutional investors, we find that the dissent to auditor ratification by institutional shareholders—but not retail shareholders—is positively associated with the magnitude of NAS fees which are considered to be a factor that could impair auditor independence and objectivity. More importantly, our results also indicate that the change in NAS fee to total audit fee ratio in the subsequent year is negatively associated with dissent by institutional shareholders. Thus, it appears that in response to institutional shareholder dissent, management and the auditor take action to reduce the level of NAS purchases from the auditor to signal increased independence and objectivity of the auditor.

Furthermore, we also document a negative association between institutional shareholders' votes against auditor ratification and subsequent changes in discretionary accruals. This result suggests that auditors and management are sensitive to dissent by institutional shareholders resulting in improved audit quality in the subsequent year. Neither the change in NAS fees nor the discretionary accruals after the vote are associated with dissent by retail shareholders. Overall, these results support the argument that institutional shareholders have a superior understanding of the workings of a company, the company management and auditors value their inputs, and that institutional shareholders have the potential to discipline managerial actions through their voting patterns.

India has the unique advantage of being one of the few countries that requires companies to separately tally and report the votes by institutional and retail shareholders. Such availability of data, in turn, enables us to directly test our hypotheses rather than relying on assumptions about the participation rates of institutional and retail shareholders in the voting process. Subject to availability of data, future research can examine whether similar voting patterns are observed in other countries. In addition, future research can also explore

additional determinants and consequences of dissent by different types of shareholders on other resolutions related to the operations of a company.

The findings of our study are timely considering recent actions by regulators in some countries to increase the participation of retail shareholders in the voting process. For example, the United States SEC (2018) recently convened a roundtable with the aim of changing the proxy voting process and increasing the participation of individual shareholders. In addition, our results also provide empirical evidence about the efficacy of auditor ratification voting as a monitoring and disciplining mechanism. This is also relevant to the debate about making such auditor ratification voting mandatory in the United States and in other countries (Aguilar, 2012; Brown, 2012; Dao et al., 2012; Mayhew, 2017).

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## Data Availability

Data used in this study are available from public sources identified in the text.

## Notes

1. Mayhew and Pike (2004) show, in an experimental setting, that direct shareholder involvement in auditor selection is associated with higher audit quality.
2. Based on a ranking of nominal GDP, India has grown from being the ninth largest economy in 2010 to the fifth largest economy in 2020 (World Economic Forum, 2020).
3. The results of Tanyi et al. (2020) employing U.S. data indicate that shareholder dissatisfaction in auditor ratification votes leads to improved audit effort and better financial reporting quality. However, Tanyi et al. (2020) do not examine how voting results or subsequent audit outcomes vary with the differential voting patterns of retail and institutional shareholders—which is the focus of the current article.
4. Companies are required to notify the shareholders at least 21 days prior to the AGM. The notice of the AGM consists details of the resolutions to be proposed at the meeting along with all the supporting details of the resolutions. Shareholders can cast their vote either remotely through e-voting or personally or through proxy at the AGM.
5. These services are (a) accounting and book-keeping services; (b) internal audit; (c) design and implementation of any financial information system; (d) actuarial services; (e) investment advisory services; (f) investment banking services; (g) rendering of outsourced financial services; (h) management services.

6. In our sample, on an average, firms pay an amount equivalent to about 26% of their audit fees for non-audit services.
7. Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.
8. As against an *ordinary* resolution, a *special* resolution is one where a majority of more than 75% votes (i.e., a special majority) is required to approve the resolution.
9. During the sample period, many companies in India became subject to mandatory auditor rotation, which was introduced by the Companies Act, 2013, resulting in a mandatory change of auditor for many companies in our sample.
10. The Cragg (1971) hurdle model has been used in various contexts in accounting studies. Some of the recent studies include Kuo (2017), Nessa (2017), K. Kim et al. (2016), and Black et al. (2014), among others.
11. In un-tabulated tests, our conclusions regarding the test of H1 remain unaltered using a censored Tobit model. We use the two-part hurdle model, as a likelihood-ratio test rejects the Tobit model in favor of the two-part hurdle model. In addition, the hurdle model allows the effects of independent variables to be separately estimated in the *choice* decision and the *magnitude* decision, a flexibility not afforded by the Tobit model.
12. We use signed discretionary accruals instead of absolute discretionary accruals, as shareholders are more likely to object to income-increasing discretionary accruals, which have been shown to increase the risk of auditor litigation (see Heninger, 2001).
13. In un-tabulated analysis, we also control for corporate governance characteristics of the firm such as the number of members on the board of directors, board independence, and the number of board meetings in the financial year. We do not include these covariates in our main equation as they reduce the sample size. Our main results are robust to these additional controls.
14. As discussed earlier, the audit committee plays an important role in influencing the appointment of auditors and as such, the characteristics of the audit committee are likely to affect shareholders' votes on auditors' appointment. However, in absence of computerized data related to various audit committee characteristics, we are not able to control for them in our estimations, which is a limitation of our study.

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