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Accounting History; May 2003; 8, 1; ProQuest Central
pg. 25

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Abstract

This study presents an historical perspective on mergers and acquisitions by major US accounting firms throughout the twentieth century with special emphasis placed on such activity during the last fifty years of this period. The focus of this perspective is: (1) the importance of mergers and acquisitions in the formation and growth of major accounting firms; (2) the relationship between the internationalisation of trade and the internationalisation of major accounting firms; and (3) the ways in which accounting firms have used mergers as a response to an increasingly competitive environment.

Keywords: *accounting history; accounting firms; growth of firms; internationalisation; mergers and acquisitions.*

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Acknowledgements: Appreciation is expressed to the editor, Garry Carnegie, and two anonymous referees for their excellent suggestions. We are also grateful to the anonymous reviewer for, and participants at, the *9th World Congress of Accounting Historians*, Melbourne, 30 July to August 2002 for their helpful comments.

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Introduction

> The growth of individual firms to great size through merger with rivals is an outstanding development of modern economic history ... . There are no large American companies that have not grown somewhat by merger ... (George J. Stigler, 1950, p.23).

> If it is bigness that it takes to have any say in the accounting profession, why then we will concentrate on first things first. We'll get big (Leonard Spacek, senior partner, Arthur Andersen, 1989, p.55).

Growth, diversification and influence by a corporation or accounting firm can be achieved in two major ways (Goldberg, 1973, p.19). One method, as Nobel Economist George Stigler writes, is through mergers while the other is through internal growth and diversification. For the first half of the twentieth century, growth for many accounting firms (for example, Arthur Andersen and Arthur Young) was largely internal while at other firms, such as Haskins & Sells, a large portion of their growth resulted through mergers. However, in the latter half of the twentieth century, the value of growth through mergers became apparent to the major firms. By the 1980s, all leading US accounting firms were involved in major merger discussions. With the resulting mergers, as the twentieth century ended, the number of major US accounting firms had been reduced to five (and then four with the demise of Arthur Andersen). But, in reality, the four firms had evolved beyond the US to become what Michael Porter (1990, p.251) describes in *The Competitive Advantage of Nations* as global firms, that is, "[firms] that service multinational clients anywhere, differentiating itself from the local competition. Worldwide brand reputations can be built that overshadow those of local firms". Thus, with the emergence of these global firms, Stigler's (1950, p.23) assertion that "there are no large American companies [firms] that have not grown somewhat by mergers" seemed to have proved to be true.

With the Big Eight and Big Six's mergers relatively fresh in mind, accounting mergers often are thought of as a recent phenomenon occurring mostly during the last two decades. However, the histories of many accounting firms reflect almost nonstop merger activity. Firms, such as KPMG and Ernst & Young, are the result of dozens, if not hundreds, of local, national, and international mergers. Over the years, accounting firms have used mergers as a way to grow, diversify and specialise as they sought a competitive advantage in the marketplace. Mergers have allowed firms to acquire offices in new geographical areas with minimum capital expenditures. Mergers have enabled accounting firms to expand the services they offer, and in effect, become Professional Services Providers, not simply audit and tax firms. And, as Gerard Hanlon (1994, p.48) writes in *The Commercialisation of Accountancy*, mergers have taken place "to give the firms greater size thereby giving greater expertise, capacity and international scope". With the international

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scope has come "economies of scale [that] allow the global service firm to spread the cost of technology development, training infrastructure, and other activities over worldwide sales revenue" (Porter, 1990, p.251). Thus, as with other enterprises, mergers have served as a way for accounting firms to respond to their changing environment (Wootton *et al.*, 1994, p.58).

In many respects, the history of merger activity among accounting firms mirrors that of industrial corporations. However, historically accounting firms have faced unique problems due to the service nature of their business and the traditional partnership form of their organisation.[1] Unlike corporate mergers where negotiations are between two distinct corporate entities, accounting mergers are the results of negotiations between individual offices and often individual partners. As a result, in national and international mergers, partners in individual offices have voted not to merge with the new firm and instead have agreed to merge with yet another firm or created their own independent firm.

This study presents an historical perspective on mergers and acquisitions by major US accounting firms during the twentieth century with a recognition of the unique problems they face.[2] A special emphasis is given to the factors that motivate firms to grow or to acquire other firms and, in turn, the rationale for the targeted firms to accept such offers. Where possible, we try to set forth the reasoning behind specific firms' periods of growth, mergers, or diversification. An important emphasis is given to the relationship between the growth in size and internationalisation of major clients and the internationalisation of accounting firms through overseas mergers, "as only the very biggest firms are capable of undertaking the biggest audits and of providing the range of consultancy services demanded by multinational companies" (Willmott & Sikka, 1997, p.835). We also examine mergers that have resulted from what Radcliffe *et al.* (1994, p.620) refer to as "the entrepreneurial expansion" of accounting as accounting firms "enter into areas as diverse as personnel recruitment, management consultancy and the provision of data processing services". Within the historical time frame, the last fifty years receive greater attention for this is the period within which accounting firms have seen their greatest changes and achieved their largest growth.

Although many different firms are examined, the study concentrates on major (first and second tiers) accounting firms. For most of twentieth century, eight first-tier firms – known as the *Big Eight* – dominated the US accounting profession. These firms were: Arthur Andersen; Coopers & Lybrand (Lybrand, Ross Bros. & Montgomery); Deloitte Haskins & Sells (Haskins & Sells); Ernst & Whinney (Ernst & Ernst); Peat, Marwick, Mitchell; Touche Ross (Touche, Niven, Bailey & Smart); Price Waterhouse, and Arthur Young. As a result of Big Eight mergers, the Big Eight was reduced to the Big Six: Andersen Worldwide; Coopers & Lybrand; Deloitte & Touche; Ernst & Young; KPMG Peat Marwick, and Price Waterhouse. With the merger of Price Waterhouse and Coopers & Lybrand, the demise of

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Arthur Andersen,[3] and name changes, the largest firms now are Deloitte Touche Tohmastsu, Ernst & Young, KPMG, and PricewaterhouseCoopers.

The early years of mergers

Growth, internationalisation, and mergers have been a part of major accounting firms since their early years. For example, only twenty-five years after S.L. Price, William Holyland and Edwin Waterhouse established a partnership in London in 1849 (Jones, 1995, p.25) that became Price Waterhouse & Co. (DeMond, 1951, pp.1-3),[4] the firm opened an office in New York City quickly followed by one in Chicago. In 1894, Price Waterhouse combined the branches[5] and established the firm of Jones, Caesar & Co. (DeMond, 1951, pp.13-26). Five years later, Price Waterhouse established a firm under its own name in the US; however, the firm of Jones, Caesar & Co. continued to provide public accounting services. Over the next two decades, the importance of Jones, Caesar & Co. declined as Price Waterhouse became the auditor of choice for many American companies. As a result, Jones, Caesar & Co. was dissolved into Price Waterhouse & Co. in 1920 (Allen & McDermott, 1993, pp.46-7).

Only six years after its formation (1895), Haskins & Sells realised the important role of the internationalisation of clients and the value of mergers on the growth and development of a firm. One of its clients, Barnum and Bailey Circus, encountered financial problems during a European tour. Realising that "other American organisations [were] planning activities in Europe," Haskins & Sells decided that a "base in London would be desirable". As a result, Haskins & Sells acquired the London accounting firm of Conant & Grant in 1901 and appointed L.H. Conant as the manager of the London office (Haskins & Sells, 1970, p.29). Although unprofitable for several years, the London office became a base for expanded European engagements (Haskins & Sells, 1970, pp.18-9).

Another early international merger was between Marwick, Mitchell & Co. and W.B. Peat & Co. James Marwick left Scotland for New York City where he formed an accounting partnership with R. Roger Mitchell. Marwick, Mitchell & Co. quickly expanded until it had nine branch offices. In 1911, while crossing the Atlantic via ship, Marwick met William Barclay Peat. Peat had been an apprentice to Robert Fletcher, a Scottish accountant, and as the sole remaining partner in 1891, he renamed the firm W.B. Peat & Co. By the voyage's end, Marwick and Peat had agreed to merge their firms into the American firm of Marwick, Mitchell, Peat & Co. It operated under this name until 1923 when it was changed to Peat, Marwick, Mitchell & Co. (Wise, 1966, p.91).

By the early 1900s, while some American accounting firms had already achieved growth and geographical expansion through external mergers, other firms concentrated on rapid internal growth. Chief among these firms was Ernst & Ernst.

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A.C. Ernst, one of the founders, had decided that "the active solicitation of business ... was no small factor in expansion" (Ernst & Ernst, 1960, p.37). In contrast with most firms and in what some claimed was a violation of accounting ethics,[6] Ernst & Ernst directly solicited clients – even using telephone calls and advertisements in journals and newspapers. To A.C. Ernst, expansion meant not only growth but also using such growth to obtain a more influential position in the accounting profession itself, a profession which Ernst believed required major changes (Ernst & Ernst, 1960, pp.36-8). As is discussed later, Arthur Andersen set forth a similar argument for its desire to grow. While Ernst & Ernst continued its rapid growth, many other accounting firms argued against the solicitation of clients and sought and sometimes succeeded in prohibiting such practices stating that solicitation violated the accounting code of ethics. Yet, as Miranti (1990, p.117) writes, such codes "might also minimise professional competition and secure the positions of the better-established firms".

As mergers proliferated, US companies grew in size and became more national in scope. As a result, accounting firms were faced with the challenge of auditing clients with plants and offices across the country. With the relocation of their clients, "sometimes accountants found themselves spending as much time 'on the road' as in their offices", but "[a] solution lay in the decentralisation of accounting firms. Where the client went – there went the accountant" (*A Half Century*, 1949, p.16). In order to decentralise, some firms opened branch offices; however, a less expensive way to obtain entry into an area often was through a merger (Allen & McDermott, 1993, p.38). Not only did a major firm acquire an office where it was needed, the firm gained access to the local firm's clients which avoided the often costly process of attracting clients to the new office.

This situation occurred when Arthur Lowes Dickinson accepted the senior partnership of the American branch of Price Waterhouse (PW) in 1904. Dickinson recognised "the necessity of correlating the development of the American firm with the expansion of American industry", and that a firm "should not be confined to any one geographical area but must follow the development of industrial corporations". With that in mind, Dickinson "embarked on a program of expansion" (DeMond, 1951, p.76). One area that looked promising was California because in 1904 no national firm had yet opened an office on the West Coast. PW believed California had great business potential. Accordingly, opening an office there would give PW an advantage over the other firms in attracting new clients (DeMond, 1951, p.73). Although it had several clients in the area, Price Waterhouse decided the best way to establish an office was to acquire a local practice namely, F.G. Phillipps & Co., in San Francisco. Reflecting on the acquisition, Allen and McDermott (1993, p.38) wrote: "This move would ensure sufficient work for the office during its early years and thus avoid the necessity of a costly promotional effort to secure additional clients for an entirely new office".

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Additionally, Hanlon (1994, p.48) writes that such efforts can prove costly because there is a "reluctance of clients to leave their existing accountants and because of the importance attached to having local people who are both known in and are aware of the regional business environment". This reason again prevailed in 1907 when Price Waterhouse decided to open an office in Philadelphia. Instead of establishing a new office, it invited Joseph E. Sterrett to merge his firm with Price Waterhouse. For Sterrett, the offer was financially attractive and with him involved in the on-going firm he "brought great luster to the [new] firm and throughout his career he served in numerous important professional capacities" (Allen & McDermott, 1993, p.41).

Another firm actively involved in mergers was Haskins & Sells (H & S). Under the leadership of Colonel Arthur Carter, who later became the firm's managing partner, Haskins & Sells set upon achieving the goal of "firm expansion and development". Carter was aided in his expansion search by "his military experience [that] had taken him to many parts of the Country and the Far East, and helped by this knowledge" he arranged mergers with twelve accounting firms between 1919 and 1923, including firms in Boston, Dallas, Denver, Detroit, and New Orleans (Haskins & Sells, 1970, pp.69-70). In addition to the advantages the mergers provided in establishing or strengthening offices in strategic cities, the mergers often produced "excellent partners" for the firm. For example, in 1912, Haskins & Sells acquired the San Francisco practice of John Franklin Forbes. During his twenty-five years with Haskins & Sells, Forbes served the firm as managing partner of the San Francisco office, District Manager of the Pacific Coast Offices, and Senior Partner of the national firm (Haskins & Sells, 1970, p.38).

After World War One, major US accounting firms realised that many clients had become more international in operations and thinking. Moreover, as stated in Haskins & Sells (1970, p.128), "the practice of serving American clients in connection with their manufacturing and distribution centres abroad was expanded by the influx of American capital in Europe, especially in Germany". Some accounting firms responded to internationalisation by acquiring overseas firms and establishing worldwide branches. For example, in 1920, Haskins & Sells acquired the Shanghai accounting firm of Stevenson & Carson. Then, over the next six years, Haskins & Sells opened offices in Havana, Paris, and Berlin, the latter of which had become a major centre for international banking. In 1924, H & S also reached an agreement with Deloitte, Plender, Griffiths & Co. to establish a joint firm, Deloitte, Plender, Haskins & Sells, to handle engagements in Canada, Cuba, and Mexico (Haskins & Sells, 1970, pp.127-9).

Other American-based firms such as Ernst & Ernst and Arthur Young & Co. responded to the internationalisation of clients by initiating working relationships with more established and internationally viable British firms.[7] For example, after a period of rapid expansion in the US, Ernst & Ernst decided "that some overseas

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facility was required if full service to its clients were to continue". In 1924, Ernst & Ernst established a working agreement with the London firm of Whinney, Smith & Whinney (WSW) (Ernst & Ernst, 1960, p.74). A key element of the agreement was that WSW would conduct the audits of Ernst & Ernst's American clients (for example, Chrysler Motors) that had established branches in Europe (Jones, 1981, p.144). This relationship continued and grew for many years until the firms merged creating the international firm of Ernst & Whinney.

Depression and World War Two

With the onset of the depression, merger activity between accounting firms declined and remained at a low level for more than twenty years. Whereas, Haskins & Sells merged with twelve firms between 1919 and 1923, it merged with only three firms between 1924 and 1952 (Haskins & Sells, 1970, p.101). Additionally, what little merger activity there was during the 1930s came to an almost complete halt with the beginning of World War Two. During the war, most firms faced personnel shortages, increased needs for accounting services, and greater responsibilities to their clients. They had little time to devote to the complex procedures required to consummate a successful merger. Expansion for most firms was limited to opening branch offices in cities where they could better serve their clients or to help with the war effort.

This was the case with Arthur Andersen & Co. By 1930, Andersen had several clients with operations in Europe, including American Telephone & Telegraph and Colgate-Palmolive. Because of the need to serve these clients, Arthur Andersen engaged the London firm of McAuliffe, Davis & Hope to represent it in Europe. Later, after McAuliffe, Davis & Hope had merged with Turquand, Youngs & Co., Andersen began discussions with Turquand, Youngs concerning the creation of a worldwide firm. If such a venture was not possible, Andersen proposed to create a separate firm to "handle work outside the United States and Great Britain, or possibly an affiliation of a number of firms into a joint undertaking".These discussions, however, were deferred when World War Two began (*The First Fifty Years*, 1963, pp.100-1). Even after World War Two, major firms were slow to begin merger activities. Arthur Andersen & Co. and Turquand, Youngs & Co. did formalise their pre-war working relationship with the creation of Arthur Andersen, Turquand, Youngs & Co. to handle the work of both companies on the Continent, Andersen's work in the UK and Ireland, and Turquand's work in the US (*The First Fifty Years*, 1963, pp.103-4).

There was, however, one significant merger in the 1940s, which illustrated the unique issues accounting firms faced when they merged. George Bailey had joined Ernst & Ernst in 1912 and, by 1922, was the managing partner of the Detroit office. Over the years, differences developed between Bailey and A.C. Ernst, founder of the firm. By 1947, differences had escalated to the point that Bailey left

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Ernst & Ernst accompanied by another partner, John McEachren, as well as eleven associates. During his twenty-five years as head of the E&E office, Bailey had developed a good relationship with several corporate clients so, when he left, several clients went with him to his new firm, George Bailey & Co. (Swanson, 1972, pp.9-10). Before Chrysler Corporation would agree to become a client, however, it stipulated that the firm had to have a national organisation. This stipulation, together with a shortage of personnel, encouraged Bailey to merge his firm with two established firms (Touche, Niven, & Co. and Allen R. Smart & Co.) to form Touche, Niven, Bailey & Smart (Swanson, 1972, pp.9-10). Several mergers and reorganisations later, the firm would become Touche Ross & Co. and finally Deloitte & Touche.

In 1946, representatives from Price Waterhouse's major regions (US, UK, Canada, Europe and South America), met to establish an international firm. Reflecting upon this, John B. Inglis (senior partner PW) writes (1974, p.124): "The creation of the International Firm in 1946 was a forward and constructive step to enable the various associated firms to handle the vast amount of post war international work in the name of Price Waterhouse & Co.".

An era of mergers

The 1950s witnessed the beginning of an era of prolific accounting mergers similar to that of the 1920s. It also was a period in which size became an important consideration for many firms because of two factors. The first reason, the commonly cited one, was that greater size was needed to serve increasingly larger clients. This reason, the needs of the client, was reflected in a 1949 letter by George Bailey to the partners in his firm (Touche, Niven, Bailey and Smart). Bailey (Swanson, 1972, p.18) wrote: "I want it [the firm] to be able to handle almost any client, although we may not rank in size with the largest firms for many years, if ever". Another Big Eight partner who wanted "simply sheer growth" was William Black, senior partner at Peat Marwick. Allen and McDermott (1993, pp.114-5) credit Black "as the architect of the growth strategy ... [and it] was successful: Peat, Marwick's domestic and international mergers totalled fifty-three during the 1950s, and by the mid-1960s, Peat, Marwick led the profession in volume of business".

The second reason (often not cited) was more abstract, more personal, but probably at least equally important. That reason was a desire to obtain a leadership role in the accounting profession and to be considered as an equal by the other major accounting firms. In *An Oral History,* Leonard Spacek (1989, p.55) talked about the impetus for Arthur Andersen to grow. Shortly after he assumed the position of managing paper upon the death of Arthur Andersen in 1947, Spacek attended a meeting with George O. May in New York City (Spacek, 1989, p.54). May told him that "the leadership of the accounting profession must rest in the hands of the larger, successful firms". Spacek (1989, p.55) said that May's

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comments "had a terrific impression on me because I was just trying to work out our leadership in the profession". Spacek (1989, p.55 and 57) continued: "[I decided] if it is bigness that it takes to have any say in the accounting profession ... . We'll get big ... we had to do only one thing – growth, service and expansion".

Regardless of the reasons for growth, it was during the 1950s when firms that previously had concentrated upon internal growth began to recognise the value of mergers as a means of expansion and diversification. For example, prior to 1950, Arthur Young & Co. had not been involved in one merger. However, the two mergers completed within that year illustrate the value of a merger to both the acquirer and acquired, and in his autobiography, Thomas G. Higgins (senior partner Arthur Young & Co.) discusses the reasons. From Arthur Young's viewpoint, it needed a larger office in Kansas City and felt "that it would be advantageous to [also] have a Wichita office because we had a substantial amount of work in that general area". Moreover, it was felt that the acquired firm (Lunsford, Barnes & Co.) "would add a good deal to our pool of talent". From the acquired firm's viewpoint, a merger with Arthur Young was logical because "the two senior partners of that firm wanted to retire – Lunsford because of age and Barnes because of failing health" (Higgins, 1965, p.217).

In *The Determinants and Effects of Mergers*, Hughes *et al.* (1980, p.31) reflect upon the value of this motive: "mergers may be the most profitable way for a family-controlled firm's management to liquidate its assets in the firm upon retirement". This motive also correlates with a 1998 study in which the Accounting Practice Committee found that retirement and succession were major factors in the merger of smaller firms stating that "many firms lack a good plan for succession. They may also have retirement plans that are inadequately funded to deal with older partners" (Mastracchio, 1998, p.3).[8]

Arthur Young's merger with Wideman, Madden & Dolan (WMD) illustrates other incentives for smaller firms to merge with a major firm. Reflecting upon the merger, the Arthur Young senior partner (Higgins,1965, pp.218-19) writes that WMD had found that "they were failing to get certain work ... simply because they were a local firm ... , it was difficult for them to retain a client once the company went public ... , and [it was] difficult to service the increasing number of their clients whose activities were spreading out across the country". Moreover, they were becoming aware of the need for "a larger 'umbrella' to provide security for themselves and their group of loyal employees". Thus, to WMD, a merger with Arthur Young was a logical answer to several concerns. To Arthur Young, [who] "had learned from experience that to start an office from scratch in a new city often produces long-range problems", the merger provided two well-established offices in Toledo and Detroit that were already well staffed and knowledgeable of the local clientele. It was the great success of this merger which lead Higgins (1965, p.221) to comment that the experience: "convinced us that our contemplated domestic expansion could be helped substantially by merging with reputable local firms".

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Probably the most significant merger in the period that illustrated the value of a merger to both the acquired and acquiring firms was between two of the oldest and most prestigious US firms (Barrow, Wade, Guthrie & Co. and Peat, Marwick, Mitchell & Co.). Barrow, Wade, Guthrie, & Co. (BWG), often considered the first accounting firm to be organised in the US, (Wise, 1982, p.1),[9] had billings of approximately $4.5 million at the time of the merger and probably was equal in size to Arthur Young (Wise, 1982, p.46). However, BWG was involved in a major lawsuit over its audit of CIT Corporation and previously it had been found "negligent in failing to detect an overstatement of profits of a company offering shares to the public". These legal difficulties convinced BWG's management that "it needed stronger staff training and supervision" (Wise, 1982, p.46), but, at this time, BWG did not have the financial resources or leadership to establish such training. Thus, to ensure its survival, a merger with PM was a logical choice for BWG. From PM management's viewpoint, the merger "was a golden opportunity" for the two firms had duplicate offices in fourteen cities, thus, allocating the increasing overhead costs (for example, research and training) over a much greater client base. Moreover, BWG was a leading auditor in the insurance area – an area in which PM saw great potential for growth (Wise, 1982, p.46).

In discussing the benefits of the BWG merger, William Black, senior partner of PM, stated that the merger also had a "great psychological impact within the profession", especially on the founders of small independent accounting firms. Many had established successful firms that had grown through specialisation (for example, lumber, cooperatives and oil), however, many of the founders "now were in their fifties and sixties" and were faced with a series of major problems – they often did not have a plan for succession, they faced major estate-tax payments, and with increased ligation there was greater potential for personal liability (Wise, 1982, p.46). Summing up these problems and the solutions that a merger with PM could provide, T.A. Wise (1982, p.47) writes:

> Thus the combination of age, increasing responsibilities, and risks versus rewards worried the partners who wanted to be sure their years of labor assured retirement years of leisure and comfort. Peat Marwick was ready to assure them of those goals ... . These were forces that the Barrow, Wade, Guthrie & Co. acquisition crystallized in the minds of many independent CPAs and that simplified the PMM & Co. road to growth.

Thus, although accounting firms increased in size and expanded the number of services offered during this period, US corporations also grew larger, more complex, and more international in scope. With these changes, audits increased in complexities and cost. For example, most firms had offices in large US cities, but they often did not have branches in smaller cities where clients' plants were often located or in the foreign countries to which clients had expanded. In addition, an increasing emphasis on management services required more staff members leaving

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fewer people available for audits. Because of these changes many firms faced three problems. First, there was a need for additional nationwide or worldwide offices. Second, there was a need for more personnel to handle the growth in services offered. Third, there was a need for greater volume over which to assign increased costs. T.A. Wise (1982, p.47) addressed the uniqueness of increasing services and geographical expansion at accounting firms:

> It has to be kept in mind that unlike conventional business, a professional firm cannot simply decide to enter a certain field of practice by appropriating a specific amount of capital, hiring the people, and starting operations. Nor can it simply buy a market where it lacks representation. It cannot move effectively unless it has people who are competent and knowledgeable in the field as well as qualified to practice in the jurisdiction of the area.

Often one answer to these problems was a merger. Through a merger, an accounting firm could obtain an office where a client was located and gain qualified personnel who were familiar with local practices. A merger also provided a way to gain national or international exposure. And, maybe more important, Porter (1990, p.245) writes: "a multi-unit firm can gain substantial competitive advantages over single-unit firms, both in the service delivery process and especially in support activities". Because support activities were to become an increasing costly activity at many firms, mergers were extremely attractive to firms during this period.

For example, examining the mergers of Haskins & Sells between 1952 and 1960, one can see how H & S expanded its geographical exposure and, in effect, tried to become a "multi-unit" firm. In eight years, Haskins & Sells merged with firms in London and San Francisco (1952), New York (1953), Portland and San Diego (1954), San Juan and Cincinnati (1955), Los Angeles, Rochester, Honolulu, Omaha, and Birmingham (1956), Seattle (1957), Hilo and Rochester (1958), Phoenix and Salt Lake City (1959), as well as San Diego and Dallas (1960) (Haskins & Sells, 1970, pp.101-9). One important merger was Haskins & Sells' acquisition of McLaren, Goode & Co. which was headquartered in San Francisco. At this time, McLaren Goode had offices in San Francisco, Los Angeles, Seattle, and New York. As a result of the merger, Haskins & Sells acquired sixteen new partners (Haskins & Sells, 1970, p.108).

Another reason for a merger was a firm's desire to increase its client base for the parent firm normally acquired the clients of the acquired firm. This was the case in 1955 when Price Waterhouse merged with R.G. Rankin & Co. Reflecting the philosophy of George O. May, Price Waterhouse had not relied upon mergers for growth but depended "upon the firm's reputation". In fact, PW had not been involved in a merger for twenty-five years (Allen & McDermott, 1993, pp.116-7). However, by the mid 1950s, PW had decided that in order to remain competitive it had to reconsider its merger policy. Price Waterhouse developed a policy emphasising that mergers must not be made "for the sake of growth alone" but

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mergers must be made to "gain a special expertise or a practice area ... might be sought to bring in blue-chip clients, or to provide entree into selected geographical areas" (Allen & McDermott, 1993, p.117). Because of this revised policy, PW began to pursue mergers with firms such as R.G. Rankin & Co. Over the years, under the leadership of its founder, Russell Rankin, Rankin & Co. had obtained "blue chip" clients such as IBM, Bristol-Myers, and Ingersoll-Rand (Allen & McDermott, 1993, p.117). Thus, with this acquisition, Price Waterhouse gained not only several prestigious clients but the merger reinforced PW's image as the leading auditor of manufacturing companies.

One of the most significant mergers of the 1950s was the creation of the international firm of Coopers & Lybrand in 1957. The firm was the result of the combination of Cooper Brothers & Co. (UK); Lybrand, Ross Bros. & Montgomery (US); McDonald, Currie & Co. (Canada); Despacho Roberto Casas Alatriste (Mexico); and Treuhand-Verinigung A.G. (Germany) (L. R. B. & M.,1958, pp.2-7). Reflecting on the creation of Coopers & Lybrand, Campbell Leach (partner McDonald, Currie–Coopers & Lybrand, Canada) states (Leach, 1976, p.147): that the impetus for the creation of the international firm of Coopers & Lybrand was that Lybrand, Ross Brothers became "disenchanted with their Paris office" causing the firm "to seek out some UK firm to act as their agents in the European practice ... and that was Coopers". However, during the discussions, the participants "quickly ... [saw] this could be the basis of a really international firm and made the proposal that the firm of Coopers & Lybrand be formed as the keystone". In the US, the firm continued to operate as Lybrand, Ross Bros. & Montgomery until 1973 when the firm's name was changed to Coopers & Lybrand.

Unlike many Big Eight firms, Arthur Andersen's growth in the US "had been almost entirely without acquisitions and mergers". However, when it decided that an international presence was required to serve its clients, Andersen decided this "necessitated the acquisition or merger of well-established, reputable local practices" (*The First Fifty Years*, 1963, p.105). In *An Oral History*, Leonard Spacek reflected upon AA's impetus for a greater international presence. George Fry met with Spacek and told him that his consulting firm would soon open a series of international offices and asked if Arthur Andersen would be able to serve them. Spacek stated (1989, pp.113-4) that he wanted to say yes, "But I said, 'No' ... you'd better get Price Waterhouse", but this conversation established the need in his mind. In 1957, Arthur Andersen acquired all the accounting offices of Turquand, Youngs & Co. in South America for $75,000 cash (Spacek, 1989, pp.49-50). In 1958, Andersen acquired Hunter, Smith & Earle, a Venezuelan firm. Then in 1961, Arthur Andersen & Co. merged with the Australia firm of Fuller, King & Co. which had offices in Melbourne, Perth, and Sydney. Andersen had a long relationship with Fuller, King starting in 1937 when the firms signed a representation agreement (*The First Sixty Years*, 1974, p.52). In addition, Arthur

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Andersen terminated its European working relationship with Turquand, Youngs & Co. and began to open its own offices in Europe (*The First Sixty Years*, 1974, p.49).

During this period, second-tier firms also reacted to the internationalisation of their clients. For example, by the early 1960s, a leading second-tier firm, Seidman & Seidman, had reached the conclusion "that if it didn't find a way to provide services overseas, it would lose out at home as well" (*75 Years*, 1985, p.63). In 1962, Seidman & Seidman established formal working relationships with accounting firms in Canada, Germany and the Netherlands and informal relationships with firms in several other countries. The following year, Seidman & Seidman (US), Binder, Hamlyn & Co. (UK and Australia), Deutsche Warentreuhand (Germany), Frese, Hogeweg, Meyer & Horchner (Netherlands), and Thorne, Mulholland, Howson & McPherson (Canada) met to establish an international consortium of firms to operate under the international name of Binder Seidman International Group. Over the years, the group would continue to grow and, in 1983, a worldwide partnership was established with the name "BDO ... adopted worldwide for international practice" (*75 Years*, 1985, pp.66-7).

Firms continued to use mergers and acquisitions as a means of expansion and growth throughout the 1960s and 1970s, however, additional reasons for mergers became apparent. In his book, *Scale and Scope*, Alfred D. Chandler (1990, p.76) writes that although one goal of mergers can be geographical diversification or expansion, many companies also realise "that mergers through scale economies based on carefully scheduled high-volume flows ... [can provide a] more certain source of profit and market power". It was in the 1960s that the concept of scale economies became an increasingly important consideration in mergers. For example, although Touche, Ross, Bailey & Smart (TRB&S) had grown in the 1950s, it realised that greater growth was needed. According to the firm's managing partner, Robert Beyer, a principal reason for the firm's need to grow "on a major scale" was the massive increase in spending on the research and training functions that had occurred. In order to remain competitive, TRB&S had to have a greater base over which to allocate these costs as Beyer (Swanson 1972, p.18) stated: "we had to broaden our base not just to keep up, but to move ahead". And it did grow, for in ten years Touche, Ross, Bailey & Smart merged "with some 50 US firms and [achieved] international expansion through formal associations with firms in more than 75 countries" (Swanson, 1972, p.10).

In his 1965 autobiography, Arthur Young's senior partner, Thomas Higgins (pp.300-1), reflected upon the need for growth in stating: "in today's environment, any public accounting firm that serves large clients must itself be large". Higgins (1965, pp.301-2) then set forth two reasons for this need which reflected the concept of scale economies. First, the operations of large companies are spread throughout the world and "highly skilled personnel [are needed] in each of the corporation's key locations". Second, to provide such highly skilled personnel

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there has to be "an extensive program of recruitment and training ... [and such] programs are extremely costly, and without a large volume of business few firms would be able to support them".[10] Thus, mergers were a logical choice as firms strove to increase their business volume to support such costs and to obtain a "more certain source of profit and market power" (Chandler, 1990, p.76).

Another large merger of the 1960s involved Lybrand, Ross Bros. & Montgomery (Coopers & Lybrand internationally) and Scovell-Wellington. Scovell-Wellington ranked tenth in the number of NYSE Companies audited and was one of the stronger second-tier firms. The 1962 merger added thirty-five partners to Lybrand, Ross Bros. & Montgomery and increased the number of US offices from twenty-nine to thirty-five. Both firms operated in nine of the cities, so these offices were combined (*The Wall Street Journal,* 8 October, 1962, p.10). As was true in later years, mergers offered firms a way to expand their geographic base without the major capital expenditures required to start a firm in a new location. In some cases it required no capital expenditures at all – which was the case with the Scovell-Wellington and Lybrand, Ross Bros. & Montgomery merger (*The Wall Street Journal,* 8 October 1962, p.10).

Another important merger of the 1960s was the 1963 merger between Pogson, Pelouibet & Co. and Price Waterhouse & Co. (*The Wall Street Journal,* 22 March 1963, p.4). As discussed, when PW established its merger policy in the 1950s, one reason set forth for a merger was to "gain a special expertise or a practice area" (Allen & McDermott, 1993, p.117). This was the case with Pogson, Pelouibet & Co. (PPC). Although only a third-tier accounting firm, PPC was probably the leading auditor of mining companies; its clients included Anaconda Co., Phelps Dodge and Newmont. In contrast, while Price Waterhouse was the premier auditor of manufacturing companies and dominated such industries as oil, it audited only a few mining companies. Thus, with the PPC merger, Price Waterhouse acquired the most prestigious mining companies as clients and set the stage for its future growth in the mining audit area.

In a 1979 address to the firm's partners, William S. Kanaga (Chairperson, Arthur Young & Co.), reflected upon the merger era (*Arthur Young Quarterly,* 1980, p.5):

> When I signed the AY partnership agreement about a decade later in 1960, I was in the class that included the 100th partner in the firm. With the mergers of the 50s and 60s, we became truly national; by 1969 we had 246 partners ... . The end of the 1960s signaled the high water mark of the merger era for us. We added 19 partners by mergers in fiscal 1969, 10 in 1970, and only 9 in the nine years since ... .

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Growth and internationalisation

The late 1960s and 1970s saw the continued growth, diversification and internationalisation of accounting firms as "it became increasingly important to have a connection or an office overseas" (Hanlon, 1994, p.49). Moreover, Edgar Jones (1981, p.208) writes in *Accountancy and the British Economy*, "the continued growth in the size of client businesses and their demands for specialist services combined to provide a powerful impetus for larger accountancy practices". In fact, Jones points out, as companies expanded, there was concern on the part of smaller accounting firms that "without corresponding geographical growth they might lose part or even all of the work".

A merger was a logical choice for international expansion. Accounting firms could have established overseas branches, however as E.A. Collard (1983, p.133), in *125 Years at Touche Ross*, writes: "they would face inescapable problems in trying to do business as foreigners in strange places ... expanding at a time when nationalism was rising and becoming more than ever assertive". In contrast, Collard points out that a firm could merge with an established "indigenous foreign firm" in which case the work would be carried out by "people who spoke the language of the country, who were of its race and culture, familiar with local conditions, and had a basis of local work". Thus, as Touche Ross did during the period, many firms sought mergers or associations with established foreign firms to complete their international expansion.

Two important combinations in this time period involved American and British firms. In 1952, Deloitte, Plender, Griffith & Co. merged its US practice with Haskins & Sells while Haskins & Sells merged its London and Paris offices with Deloitte, Plender, Griffith & Co. (Deloitte & Co., 1982, pp.140-1). Internationally, these mergers complemented each other on audits and services to clients. In 1978, the firms formalised the relationship with the creation of the international firm of Deloitte Haskins & Sells (*The Wall Street Journal*, 10 January 1978a, p.12).

In 1979, Ernst & Ernst (an American firm) and Whinney, Murray & Co. and Turquand, Barton, Mayhew & Co. (both British firms) agreed to form Ernst & Whinney International. Ernst & Ernst had already had a long working relationship with Whinney Murray & Co., for in 1924, A.C. Ernst decided that instead of opening offices in Europe his firm would affiliate with a European firm (Whinney, Smith & Whinney) (Ernst & Ernst, 1960, p.74). Over the years, the relationship grew stronger with separate partnerships established to act for the firms on the Continent and the Middle East (Jones, 1981, p.246).

In 1979, the international firm of Ernst & Whinney was created with 304 offices in 71 countries, more than 14,000 employees, and billings of more than $500 million. As was often the case, the justification was the advantage of increased size. Greater size offered the possibility of increased efficiency through

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common training and audit preparation costs. It also provided better international coverage for clients (*The Wall Street Journal,* 17 January 1979a, p.14). As Hanlon (1994, p.49) points out, an opportunity to increase spatial (geographical) coverage is an important factor in the consideration of an international merger for worldwide offices are required to serve worldwide clients. Moreover, international mergers can increase the ability of a firm to serve its clients for individual firms can bring specific geographical market strengths to the merger. This was the case in the Ernst, Turquand, Whinney merger: Turquand was strong in Asia, Whinney was strong in the UK and Europe, and Ernst was strong in the US (Hanlon, 1994, pp.48-9). Together, the three merged firms (Ernst & Whinney International) had the ability to provide a complete, seamless service package (for example, audit, consulting, tax) to clients throughout the world.

In the 1970s, several mergers occurred among the twenty largest accounting firms in the US. For example, Niles & Niles merged with Haskins & Sells, S.D. Leidesdorf & Co. merged with Ernst & Ernst, and Touche Ross & Co. completed its merger with J.K. Lasser & Co. The Touche Ross and J.K. Lasser merger exemplified the "growth through merger" philosophy typical of the post World War Two period. At this time, Touche Ross was one of the smallest first-tier firms, and for some time, had expressed a desire to grow. In 1976, Touche Ross & Co. began merger discussions with Laventhol & Horwath (a second-tier firm), but these failed. A year later it turned to J.K. Lasser & Co. another second-tier firm with revenues of approximately $40 million (Stabler, 1977, p.4). At this time, J.K. Lasser was having financial problems and the merger's importance was reflected in the statement of a former Lasser employee (Brown, 1981, p.104): "We would eventually have gone bankrupt without the merger".

A major reason for Touche Ross' desire to grow was that several of its offices were unusually small. Russell E. Palmer (who later became Chairperson of Touche International and Dean of the Wharton School) stated the problem with small offices and the solution that mergers offered (*Forbes*, 1977, p.58):

> When an office has less than 50 people, it is next to impossible to offer clients a full range of management consulting services, or tax expertise or expertise in various specialized areas such as auditing computers ... . Take Cleveland, we were deep eighth there among the big firms with 150 employees. There was no way we could compete with Ernst & Ernst. Now we have about 275 employees there, thanks to the merger, and we can provide consulting, tax and other specialized services.

Concurring with Palmer's statement, F.M. Scherer (1980, p.83) writes that the ability to "specialise" often is an important factor in a firm's decision to seek a merger, for "with a larger output ... workers can specialise more narrowly and build up greater proficiency in their tasks". And, with workforce specialisation can come "plant-specific scale economies". Touche Ross hoped to achieve these economies through the merger for, at the time of the merger, J.K. Lasser & Co. had offices in

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twenty-seven US cities, twenty-six of which were cities in which Touche Ross & Co. had offices. By merging, Touche Ross was able to expand the size of its offices, increase specialisation, and achieve the so-called "critical mass" necessary to compete with other firms (*Forbes*, 1977, pp.58-9).

Desire for growth (size) also was an impetus for the 1978 merger between Ernst & Ernst and S.D. Leidesdorf & Co. Similar to Touche Ross, Ernst & Ernst was among the smallest first-tier firms. On the basis of size, S.D. Leidesdorf was a leading second-tier firm auditing approximately 124 public corporations (*The Wall Street Journal,* 10 July 1978b, p.4). As with Touche Ross, many of Ernst & Ernst's offices were small and the creation of larger offices offered an opportunity for greater specialisation. In addition, Porter (1990, p.245) writes the creation of a "multi-unit" firm can create an "economics of scale in recruiting, training, and motivation". By combining Leidesdorf's more than one hundred public clients with its own 766 public clients, Ernst & Ernst hoped to create an economic base large enough to compete with the larger "Big Eight" firms.

In the late 1970s and early 1980s, several second-tier firms tried to increase their competitive positions through mergers, however, most attempts failed. Three years after an attempted merger with Touche Ross failed, Laventhol & Horwath began discussions with Alexander Grant & Co., however, these discussions soon were terminated (*The Wall Street Journal,* 30 November 1979c, p.21). In 1982, Alexander Grant began merger discussions with Main Hurdman & Co. Alexander Grant's 1981 billings had been $136 million while Main Hurdman had billed $165 million (*The Wall Street Journal,* 29 June 1982, p.10). This merger attempt also failed. John A. Thompson, chair of Main Hurdman, later stated the merger discussions failed because "we couldn't balance styles" (Klott, 1984a, p.D1). Two years later (1984) Alexander Grant opened merger discussions with Fox & Co. Fox had encountered problems on several audits and, in 1983, the SEC prohibited it from accepting new public clients until a peer review of its auditing procedures was conducted. The restriction was removed in January 1984. While down playing the possibility that the merger was a response to Fox's image problem, Normal E. Klein stated that the merger (Berton, 1984b, p.6) "would provide added talent for the new firm" and "achieve economies of scale". This time the discussions were successful and Alexander Grant & Co. became the ninth largest US accounting firm with revenues of approximately $225 million.

The first major attempt to merge Big Eight firms in more than fifty years occurred in 1984.[11] In the fall of that year, Price Waterhouse & Co. and Deloitte Haskins & Sells began merger discussions. At that time, the combined firms employed 17,000 people and had nearly 200 offices in the US (Allen & McDermott, 1993, p.228). Traditionally, both firms focussed their marketing efforts on auditing so together Price Waterhouse and Deloitte Haskins & Sells audited the majority of "blue chip" companies on the NYSE and had worldwide

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billings of $1.15 billion and $940 million, respectively. Combining their audit areas was considered a "natural fit" because the firms were dominant in different industries. Deloitte was strong in utilities, insurance, and chemicals while Price Waterhouse was strong in steel and oil, and gaining strength in bank audits (Berton, 1984a, p.6). However, by the early 1980s, auditing had become less profitable as competition among the Big Eight firms increased. In response, many firms had expanded their more profitable management consulting services, however, both Price Waterhouse and Deloitte Haskins & Sells were slow in expanding these services. A merger was seen as an opportunity to increase their consulting areas, bring increased computer sophistication, reduce joint costs and duplication, and increase their competitive advantage in auditing (*Business Week*, 1984, pp.37-8). Moreover, Jones (1995, p.330) writes that to Price Waterhouse, "a particular attraction of Deloitte Haskins & Sells was their worldwide client list and the associations in Japan and ... the Philippines". However, when the merger was put to a vote in December 1984, the unique complexities of mergers involving partnerships were evident. The proposal was approved by the American partners but rejected by the British partners of both firms thereby leading to the rejection of the merger (Klott, 1984b, p.D1). In his analysis of the rejection, Jones (1995, p.332) points out that partners in a merger often "vote according to how the merger would affect them ... rather than based upon its value to the global organisation". And, in the UK, partners believed the firm to be "sufficiently large and resourceful not to need a merger", and "fearful, too, that its powerful, internally based culture would be diluted".

The first major accounting merger consummated in the 1980s was between Peat, Marwick, Mitchell & Co. and the international firm, KMG Main Hurdman. In an examination of the merger of professional firms, Greenwood *et al.* (1994, pp.239 and 244) state that most firms "emphasize [the] considerations of strategic fit" as the initial reason for their merger. An illustration of a strategic fit consideration could be the merger of Canadian and US accounting firms, seeking to strengthen their presence in the other firm's country. The merger between Peat Marwick and KMG to a great extent was an example of this goal – a greater accounting presence in the US and Europe.[12] Commenting on the importance of such a presence, Edgar Jones (1981, p.245) writes: "no sizeable international accountancy practice (serving multi-national business) could develop without a strong transatlantic partnership ... which meant that the largest accountancy firms had of necessity to open offices throughout the world, not least in America".

By the mid-1980s, KMG's objective of a major presence in the US had not been achieved (Cypert, 1991, p.18). To further this goal, KMG Main Hurdman began preliminary merger talks with other major firms but only one moved beyond the preliminary stage. In early 1985, Peat, Marwick, Mitchell began merger discussions with KMG (Berton, 1985, p.8). Due to structuring problems involving

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the proposed combination and apprehension on the part of the KMG partners, these discussions soon ended. Paul H. Boschma, Chair of KMG, couched the reason for the failure as follows: "Nationalism is very strong in Europe, and our partners at that time felt that Peat had too much of an Anglo-Saxon image" (Berton, 1986b, p.6).

In 1986, KMG Main Hurdman again decided that a major partner was necessary for it to gain a strong presence in the US. Both Arthur Andersen & Co. and Deloitte Haskins & Sells expressed interest in a merger. Ernst & Whinney even made a formal offer to KMG, but it was rejected. KMG resumed talks with Peat Marwick with which it had engaged in deliberations the year before. The discussions proved to be successful and the merger was approved by the international partners. As a result, KPMG Peat Marwick was created with more than $2.7 billion in worldwide revenues (Berton, 1986a, pp.3 and 16). For the next three years, KPMG Peat Marwick was the largest accounting firm in the world.

Big Eight accounting firms merge

The KMG Main Hurdman – Peat Marwick merger served as a catalyst for the larger mergers that followed because it proved three things (Berton, 1989b, pp.1 and 7): First, although difficult, a merger between two large international accounting firms could succeed. Second, combined firms gain access to clients that each alone does not have. Third, there are economies of scale and resulting efficiencies that make the firm a more formidable competitor. This last reason was especially important because the accounting profession was becoming increasingly competitive, especially in the audit area. With increased competition, firms were reluctant to raise prices thus they concentrated on lowering costs. One way to reduce costs, according to Scherer (1980, p.84), is to create a multi-plant (office) enterprise that can "lower administrative costs ... achieve more specialisation ... and spread production, market, and financial risks over a larger volume of activity". The extent of the merger's success in achieving this goal was illustrated by the fact that in the three years following the merger, KPMG Peat Marwick's revenues increased 44 per cent even though the combined firm had 127 fewer offices and 510 fewer partners (*Business Week*, 1989, pp.20-1).

The reality of economies of scale was especially important to smaller Big Eight firms which faced questions regarding their ability to survive and compete with the larger firms. As Arthur Andersen and KPMG Peat Marwick grew, increasing their audit market shares and expanding their services, some writers suggested that firms such as Arthur Young & Co. and Touche Ross & Co. should not be included among the first-tier firms.

As a result of questions regarding their future, a need to reduce costs, a "flat domestic audit market and the necessity of a global presence, all the firms chose to follow the strategies of specialization and strengthening through consolidation"

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(Allen & McDermott, 1993, p.238). In addition, mergers offered the potential for an expansion of non-audit services. In announcing the merger between Ernst & Whinney and Arthur Young & Co., the need to grow and compete internationally was given as a prime reason for the merger. Ernst & Whinney and Arthur Young had discussed a merger in 1984 and analysts stated that the merger would have been compatible for the firms had complementary strengths. Arthur Young had a strong Canadian practice while Ernst & Whinney had a very strong British presence (Berton, 1984c, p.3). However, the merger talks did not progress beyond the discussion stage. In 1989, fresh discussions began and this time they were successful in facilitating a merger. In the subsequent announcement (*Journal of Accountancy*, 1989, p.15), the firms stressed that the merger "will give us an extraordinary ability to deliver accounting, audit, tax and consulting services to clients of all sizes into the 1990s and beyond". In many ways, the firms complemented each other. Ernst & Whinney was strong in manufacturing and commercial banking while Arthur Young was strong in high tech companies and investment banking. Internationally, the combined firms would hold the number one audit position throughout most of the world (Newport *et al.*, 1991, p.20).

Another important consideration in the Ernst & Whinney/Arthur Young merger to form Ernst & Young was the belief that the combined firms could achieve greater economies of scale. A major contributor to this belief was the "functional and industry specialization in public practice ... [that had] evolved over the past century ... in response to the particular needs of the marketplace" (Mednick & Previts, 1987, p.220). With increased specialisation, accounting firms incurred major increases in overhead costs as they devoted more resources to recruitment, training and research – especially industry specific research, and as Hughes *et al.* (1980, p.30) write: "[these costs] may be subject to minimum efficient scale characteristics that make a large firm ... more efficient". Moreover, the acquisition of the new and rapidly changing technology required to serve their clients and their own offices required vast capital expenditures. In fact, a reason cited for the merger was that it would enable "the two firms to make investments in software and artificial intelligence that would have been impractical for either firm to attempt alone" (Newport *et al.*, 1991, p.20).

Although economies of scales were achieved through the 1989 merger, their achievement proved more costly and time consuming than anticipated. Shortly, before assuming the position of managing partner at Ernst & Young in 1994, Phil Laskawy (*Financial World*, 1994, pp.38-40) reflected upon the difficulties: "Despite all the great thoughts about economies of scale, there's a major cost of putting two giant organizations like ours together". Included in the costs are "the expenses of combining offices and technology" and "sizable payouts to partners who were let go in the resulting downsizing of the firm". Moreover, there are the "less measurable" costs of a merger – the personal conflicts (for example, over

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management style and reporting responsibility issues) that can arise between partners and employees when two competing firms in the same city are combined (*Financial World,* 1994, p.38-40).

Shortly after the Ernst & Young agreement, Deloitte Haskins & Sells and Touche Ross announced their merger to create the firm now known – Deloitte Touche Tohmatsu. An important element emphasised in the merger considerations was the need to attain the critical mass required to compete with larger accounting firms. In regard to this need, Edward A. Kangas, chief executive of Touche Ross, (*New York Times,* 1989a, p.1) states:

> It has become more and more clear as business is becoming more global that while we have adequate critical mass to serve our clients in the United States, there are countries in the world where they cannot support eight major accounting firms like Hong Kong, Sweden, West Germany and France, and as a result we are seeing natural combinations.[13]

In the past, Deloitte Haskins & Sells had concentrated most of its marketing efforts on its audit area and it was a leading auditor of manufacturing firms while Touche Ross had concentrated on the retailing and financial industries. Consulting engagements generated only a small portion of each firm's revenues and it was here that the firms hoped a merger would enable them to expand. Contrasting the Deloitte/Touche merger with the Ernst/Young merger, Robert Crane's (1990, p.13) wrote: "the combination of Deloitte Haskins & Sells and Touche Ross may have been considerably closer to a 'combination of equals' than the merger of Ernst & Whinney and Arthur Young – at least in terms of the financial contributions the two make to the merged firms".

Mergers between international firms can prove to be difficult because partners in each country must approve the agreement. This difficulty was demonstrated when, in a major defection in the UK, Deloitte Haskins & Sells voted not to merge with Touche Ross but agreed instead to merge with Coopers & Lybrand, creating the largest accounting firm in the UK (*The Wall Street Journal,* 5 October 1989, p.B9). In addition, Deloitte's correspondent firms in Belgium and Austria chose to affiliate with Coopers & Lybrand instead of Deloitte & Touche (*New York Times,* 5 November 1989b, p.31). Similarly, Canada's Ernst & Whinney affiliate, Thorne Ernst & Whinney, rejected the Ernst & Young merger and announced its merger with KPMG Peat Marwick (*Public Accounting Report,* 1 September 1989, p.3). This merger was somewhat ironic as just three years before, the firm (Thorne Riddell) had defected from KMG Main Hurdman to merge with Ernst & Whinney (*The Wall Street Journal,* 6 June 1986, p.42).

In Japan, the Deloitte/Touche merger resulted in the combination of the Deloitte member firm (Tohmatsu Awoki Sanwa) with the Touche related firm (Mita) to form Tohmatsu & Co. Michael Cook (managing partner of Deloitte Haskins & Sells) described the importance of this combination when he stated that

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"'Tohmatsu Awoki Sanwa is the crown jewel of our international organization', [and moreover] ... the choice of the new international name for the merged firms – Deloitte Ross Tohmatsu International – symbolized that both Deloitte & Touche recognized the importance of the Japanese component of the firm" (Rodriguez, 1990, p.113).

During the 1980s, another attempt to merge two Big Eight firms failed. In July 1989, Price Waterhouse and Arthur Andersen began talks with the prospective of creating a firm with revenues of nearly $5 billion (Berton, 1989a, p.3) and one that would dominate both auditing and consulting. The failure of the proposed merger illustrates the difference between a "strategic fit" between firms and an "organisational fit." Greenwood *et al.* (1994, p.239) point out that most initial merger discussions emphasise the "strategic fit" between the firms, such as the resulting economies of scale, greater industry expertise, and reducing geographical weaknesses.[14] In contrast, often little attention is given to the "organisational fit", with a focus on firm structure, decision-making processes and cultural factors in seeking to combine the firms.

Initially, the merger between the two firms looked promising – the merger between the leading audit firm (Price Waterhouse) and the leading consulting firm and rapidly growing audit firm (Arthur Andersen). The merger would combine Price Waterhouse's strong international organisation and name with Andersen's consulting capability (Allen & McDermott, 1993, p.246). However, in late September 1989, talks between Arthur Andersen and Price Waterhouse were terminated (Berton, 1989c, p.2). The reasons given for the failure were numerous including: differences in the management structure of each firm, disputes over which firm would be dominant, and potential conflicts between auditing and consulting with the same clients. It was the last reason that potentially had the greatest impact. Andersen's computer consultants had established joint ventures with several of Price Waterhouse's largest clients, including IBM and Hewlett-Packard. Since an accounting firm could not then audit a business partner, the potential loss of consulting revenues may have offset any incremental revenues from the merger (*The Economist*, 30 September 1989, p.84). Thus, although the firms probably were a "strategic fit," the "organisational fit" problems between the two firms proved impossible to solve.

The 1990s – more mergers and new types of mergers

Although numerically there were not as many accounting mergers in the 1990s as in the 1980s, important mergers still occurred. For example, in 1993, the internationalisation of firms and the striving for a competitive advantage continued with the merger of Arthur Andersen with the Japanese firm, Asahi Shinwa & Co. which created the largest accounting firm [Asahi & Co.] in Japan (*Accountancy*, 1993, p.18). In *Accounting Services*, McKee and Garner (1992, p.80) write that

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geographical and service expansion is logical as "accounting firms must be sensitive to the needs of their established clients. As those clients expand into new locations, the accounting firms must extend their service networks or risk losing clients to competitors that do". With the 1989 Big Eight merger, Deloitte Ross Tohmatsu International became the leading firm in Japan, and Japan became a key element in Deloitte's international expansion. Thus, Andersen's merger with Asahi Shinwa might be seen as an attempt by Andersen to regain a leadership role in the growing but competitive Asia markets.

In 1995, the tenth largest accounting firm in the US, Kenneth Leventhal & Co., merged with Ernst & Young. The Los Angeles based firm was especially attractive to Ernst & Young due to Kenneth Leventhal's strong real estate practice (Purl, 1988, p.47). It was estimated that the two firms could generate more than $300 million in US real estate billings, much of it through consulting. In explaining why Kenneth Leventhal had agreed to merge with Ernst & Young, Stan Ross, managing partner of KL, focused on the real estate practice that would result. Leventhal stated that (*Public Accounting Report,* 1995, pp.1 and 4): "I'll be able to reach out to the marketplace on a global basis, the corporate 500 in real estate, and to large institutions that are doing much of the real estate investment now".

On 18 September 1997, the Big Six firms Coopers & Lybrand and Price Waterhouse announced they would merge. At the time of the merger, the firms had combined revenues of nearly $13 billion,[15] approximately 135,000 employees, and more than 8,500 partners. In the merger announcement, Nicholas G. Moore, Chair of Coopers & Lybrand and James J. Schiro, CEO of Price Waterhouse, emphasised the internationalisation of the firms' clients and the requirement that all firms must be able to provide comprehensive services to clients as motivating the merger. Schiro stated that (Coopers & Lybrand, 1997, np):

> Combining these two great organizations will create a tremendously dynamic professional environment that will provide our clients with the support they need to succeed in the global marketplace and will give us the unparalleled ability to develop and execute innovative and strategic solutions.

Further emphasising today's global requirements, Moore of Coopers & Lybrand, stated (Coopers & Lybrand, 1997, np):

> Equally important, combining our two organizations will also enhance our involvement with clients in providing exceptional global business assurance, risk management advice, international and national tax consulting, business turnaround and corporate finance assistance.

A total service package to a client, as Moore was describing, was now often industry specific with each industry requiring costly and often unique research. Through the merger, the respective firms hoped their combined client and research base in an industry would provide the "enhanced industry expertise ... clients have developed an appetite for" (Middlemiss, 1998, pp.20-7). In addition to the stated

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reasons for the merger, several analysts set forth the view that the proposal was an attempt by the firms to become more competitive in the lucrative and rapidly expanding consulting and technology markets (Kelly, 1997, p.16). Over the last decade, Andersen Worldwide had transformed the consulting service area and had created a new profit centre for the firm. To successfully compete with Andersen Consulting and other large consulting firms, a large capital investment was required as well as a large pool of trained specialists to serve clients' needs. Neither Price Waterhouse nor Coopers & Lybrand alone had the necessary resources. In fact, in an editorial examining the proposed merger, the *Financial Times* stated the merger probably was crucial for the survival of Price Waterhouse as a worldwide competitive entity. The *Financial Times* reported (1997, p.13): "For Price Waterhouse, the smallest of the Big Six, it eliminates the risk of dropping out of the global league". Even after the merger, the combined consulting revenues of the two firms ($2.4 billion) were still only half of what Andersen Consulting reported ($5.3 billion) (Krantz, 1997, p.A6).

The announcement by Price Waterhouse/Coopers & Lybrands was soon followed by an announcement of an even larger merger – KPMG Peat Marwick with Ernst & Young. The merger would have created the world's largest accounting firm with revenues of more than $18 billion and more than 150,000 employees. The great market strength of KPMG in Europe would have been combined with the great strength of Ernst & Young in Japan and the Middle East (Miller, 1997, pp.1 and 49). However, the proposed merger did not prove successful. From the time of its announcement, regulatory agencies in several countries stated that because of the size of the merger they would begin extensive inquiries into whether or not the proposed firm would dominate the marketplace. In February 1998, facing investigations of many more months, KPMG/Ernst & Young, in a joint statement, announced the termination of the proposed merger stating (*Accounting Today*, 1998, p.3): "The regulatory issues, together with the costs and resources required to merge the cultures of the two firms, have made the proposed merger impractical".

The 1990s also witnessed an important change in the nature of accounting mergers as they moved "into non-accountancy areas such as law, actuarial services, engineering and so on and taking on larger numbers of non-accountants" (Hanlon, 1994, p.97). McKee and Garner (1992, p.80) state that one reason for this expansion "is the case with any supplier of business services, the accounting firms must be sensitive to the needs of their established clients". As clients often had frequent contact with and confidence in their accounting firms, it was logical that clients sought out accountants for help in regard to tax matters, computer systems, and legal problems. It also was logical that accounting firms wanted to provide such services since these services were more profitable than the traditional audit.

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In *A History of Corporate Finance*, Baskin and Miranti point out two other important reasons for conglomerate mergers. First, through such mergers, accounting firms could reduce risk, for "portfolio theory provided a rationale for acquiring subsidiaries in highly dissimilar lines of business: it held that diversification was most effective in reducing risk when the elements in a portfolio had highly negative activity correlation coefficients". Second, through "synergy", a firm could obtain greater "efficiency derived from the application of advanced management techniques" (Baskin & Miranti, 1997, p.275). Agreeing that risk "is reduced by diversification", Mueller (1987, pp.34-5) adds that: "[another] managerial motive for diversification is to avoid slow or declining growth prospects facing a firm in the mature phases of its life cycle". This was the case with the major firms as little future growth was expected in the accounting/audit area. Instead, it was the consulting area that held the greatest potential for future growth and profit.

As accounting firms sought greater diversification and more profitable services, they sought alliances with consulting firms, investment companies, real estate firms, or (where the law allowed) even legal firms. For example, in January 1997, Coopers & Lybrand acquired Kwasha Lipton, a New Jersey-based consulting firm which it merged with its human resource advisory area. At the time, Kwasha Lipton, with revenues of nearly $80 million, was a leading consulting firm in the expanding area of retirement and benefit management. In announcing the merger, Coopers & Lybrand stated that it believed the acquisition would allow the firm to expand its retirement and benefit services and to create an expertise similar to the real estate expertise that resulted from its merger with Kenneth Leventhal. The merger also gave Coopers & Lybrand access to Kwasha Lipton's retirement and benefit client base which included firms such as Bank of America and Westinghouse (*Public Accounting Report,* 1997a, pp.1 and 4).

One acquisition area that probably would have been considered impossible before the 1990s was the acquisition of a law firm. However, in some countries, accounting firms can provide legal services if the person providing the service is a qualified attorney. In other countries, an accounting firm can acquire and manage a legal practice. As a result, several major firms acquired law firms outside of the US. For example, in January 1997, Arthur Andersen merged its Spanish subsidiary (Arthur Andersen ALT) with a Spanish law firm (J & A Garrigues) to create the firm of J & A Garrigues Andersen. The new firm had a legal staff of 500, including more than 60 partners. One reason given for the merger was that the consolidation of Arthur Andersen's tax practice and Garrigues' business law service would enable the firm to provide a total legal and financial planning package to its clients (*International Financial Law,* 1997, pp.3-4).

Another major change in the type of mergers was the acquisition of accounting firms by non-accounting firms. The leaders in this type of acquisition

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were the financial service giant, American Express, and the national tax preparer, H & R Block. Expanding upon its prior acquisition of smaller accounting firms, in March 1997, American Express announced that it had acquired the "$17 million advisory, tax and business and technology divisions" of a leading Chicago accounting firm, Checkers Simon & Rosner. Combined with its prior acquisitions, American Express now generated more than $100 million in accounting/tax related revenues (Beltran, 1997, pp.1 and 37). Then, in 1998, American Express acquired Goldstein, Golub & Kessler, a leading New York firm, with revenues of nearly $50 million. In stating why GG&K accepted the American Express offer instead of others, Gerald Golub (managing partner) stated: "I can sum it up in one word 'brand'... . That AmEx blue box stands for integrity, professional conduct and client satisfaction" (Miller-Segarra, 1998, p.41). To this Miller-Segarra (1998, p.41) adds: "a Fortune 100 company ... also guarantees GG&K a profitable exit strategy and employees some of the best company benefits around".

In 1999, H & R Block acquired the non-attest assets of McGladrey & Pullen, a leading second-tier firm, for $240 million cash. Although much larger than previous acquisitions, it represented Block's eighth acquisition of an accounting firm in its drive to create HRB Business Services and "to become a major force in financial services" (Fuller, 1999, pp.1 and 61). Thus, as the twentieth century ended, non-accounting giants, H & R Block and American Express continued to expand their accounting and tax services through acquisitions and therefore offered major challenges to accounting firms in the twenty-first century.

Conclusion

Today's major accounting firms are the result of a hundred years of extensive merger and acquisition activity and it appears this pattern is unlikely to be curbed into the twenty-first century. Many issues that motivated companies to merge in the past remain the same for accounting firms today: growth, diversification, economies of scale, internationalisation, or simple survival for firms in trouble. However, the fact that accounting firms compete in a service industry and have traditionally been organised as partnerships have resulted in unique issues with respect to mergers.

First, since public accounting is a service industry, much of the merger activity of accounting firms has been in response to the requirements of their client base. As clients expanded nationally and internationally, accounting firms found it necessary to expand their offices to new locations. Instead of incurring the major capital expenditures necessary to establish a new office, many firms found it quicker and economically advantageous to merge with a firm already established in the area.

Second, the internationalisation of large corporations and the resulting

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complexities involved in auditing these companies led many American firms to establish working relationships with European accounting firms. As the relationships proved successful and more worldwide offices became necessary often due to the expansion of other professional services (for example, consulting), they formalised the relationships through mergers. Both Ernst & Ernst and Haskins & Sells had long established relationships with Whinney, Murray & Co. (Whinney, Smith & Whinney) and Deloitte, Plender, & Griffith respectively when they merged internationally in the 1970s.[16]

Third, some mergers allowed firms to maximise their strengths and lessen their weaknesses. An example of this type of merger occurred between KMG Main Hurdman and Peat Marwick. In this agreement, a strong US firm (somewhat weak in Europe) merged with a strong European firm (very weak in the US).

Fourth, merger activities of accounting firms reflect the unique requirements of professionals. In order for a firm to expand to a new market or a new region of the country or the world, firms must be assured they will have access to qualified personnel who are familiar with local practices and regulation. A merger with a local firm assures that these needs will be met. Similarly, a merger with another firm that has established an expertise in a specific type of service enables a firm to increase the services offered to its clients. This concept was expanded as accounting firms entered areas of consulting and attestation not previously pursued.

Fifth, the nature of accounting has greatly changed over the past century. From small firms, providing mainly accounting/auditing services to local clients, accounting firms have grown into global firms providing multiple services to multinational companies. At the same time, accounting firms have had to become more industry specific in knowledge. Moreover, due to the vast technological advancements, accounting firms have been required to make major capital expenditures to meet their own information technology needs and the similar needs of their clients. Combined, these changes have greatly increased their overhead and fixed costs which, in turn, have encouraged accounting firms to expand the base over which such costs can be allocated. Unlike the early part of the past century, where firms often relied upon internal growth for greater volume, accounting firms have increasingly turned to mergers to provide the scale economies necessary to remain competitive in an increasing competitive field.

Unique problems of mergers involving professional service firms include: (1) the potential for conflicts of interest introduced by merger and the possible loss of clients by the merged firm; (2) the reality that mergers are the result of negotiations between individual offices and, therefore, even though a merger may be agreed to at the national or international level, specific offices may reject the proposal or decide to merge with another firm, and (3) a lack of knowledge on whether or not scale economies in service firms are realised to the extent anticipated in the original merger. The understanding of the development of the "global" accounting firm,

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thus, will be greatly helped by research that examines and contrasts the results of mergers/acquisitions made by accounting firms in the US with mergers/acquisitions made by accounting firms in other countries during this period.

Notes

1. In the early part of the twentieth century, individual offices of major firms often were established as separate partnerships. For example, "prior to 1921 the offices of Arthur Young in various cities, including New York, were local partnerships, conducted more or less independently. In that year they were united into a single partnership under the firm name and style of Arthur Young & Company" (Arthur Young, 1948, p.42).
2. Greenwood *et al.* (1994, p.254) seeks to portray the differences between a merger and acquisition: "In a true merger (which may, of course, be a relatively rare event) determined attempts are likely to be made, up front, to integrate what is seen as the best of the merging organizations both strategically and organizationally. In an acquisition, there is usually a dominant partner who drives the integration process".
3. Although it appears that the long history of Arthur Andersen as a public accounting firm has ended, due to its important role in the development of the accounting profession and accounting services, the study includes Arthur Andersen as one of the major US accounting firms.
4. Although this was the first permanent office in the US, Price Waterhouse & Co. had been involved in the audit of American firms for several years. By the 1880s, British investors were an active part of the American enterprise system investing millions of dollars in US companies or acquiring them to merge with British companies. Because British investors had great confidence in their own accounting firms, they often preferred that US companies were audited by British firms (DeMond, 1951, pp.1-3).
5. Price, Waterhouse & Co. established branches (agencies) of the UK firm in New York and Chicago under the leadership of Lewis Davies Jones and James Caesar respectively. In 1894 (effective 1 January 1895), the New York and Chicago branches (agencies) of Price, Waterhouse & Co. were dissolved and the partnership of Jones, Caesar & Co. was established (Demond, 1951, pp.25-7).
6. Miranti (1990, p.118) states: "At the annual meeting in 1921, Fred G. Angevine, an assistant solicitor at the IRS, delivered the keynote address and urged the AIA to follow the example of the American Bar Association and to adopt ethical rules prohibiting advertising and other forms of 'unethical' behavior".
7. As Hanlon (1994, p.41) points out, these early working relationships "were not full mergers; rather they were agreements to cooperate on international projects. These agreements concerned issues such as costs, standards, and so forth but not areas of

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firm strategy or structure".

8. Thomas Higgins (1965, pp.221-2) also writes that it was the great success of Arthur Young's relationships with Broads, Paterson & Co. (England) and Clarkson, Gordon & Co. (Canada) "that convinced us that we could best handle our overseas work by making ties, wherever practicable, with reputable local concerns".
9. Shortly, after their founding in the mid 1800s in the UK (London), British accounting firms began to send auditors to the US to audit companies (often railroads) financed by British investors. Thus, for much of the nineteenth century, many of the audits of major US companies were conducted by British based accounting representatives. It was only in the last two decades of the nineteenth century, that US based accounting firms were established (organised). Thus, although there were accountants/bookeepers in the US prior to BWG, BWG was the first founding (organising) of a formal (separate) accounting firm.
10. For many years, the fixed costs of maintaining an accounting staff was minimal. Moreover, recruitment and especially training costs were insignificant for most firms. During much of the first half of the twentieth century, accounting firms often relied upon "floaters" (temporary workers) to handle much of the accounting work. When a firm had a large engagement or during its busy season, temporary workers (guided by experienced accountants) were hired to fill its needs. When the engagement or season was finished, floaters were laid off (Higgins, 1965, p.301), thus, the fixed costs of maintaining an accounting staff were minimised. The busy season up to around 1930 was January, February, and March due to the fact that "practically all firms closed their books on 31 December". With the introduction of the "natural" business year, audit work could be spread around the calendar (Frazer, 1957, p.28). By 1960, accounting firms relied upon full time workers to meet their needs and the workers had to be constantly recruited and trained. Thus, the fixed costs of maintaining an accounting staff had greatly increased and the importance of a high volume of work to maintain such a staff became increasingly important.
11. In 1920, the UK offices of Price Waterhouse & Co. and W.B. Peat & Co. discussed the merger of the two firms, including their respective offices on the Continent and South America. The partners of both firms approved "a new, merged partnership be established as from 1 October 1920 to run for a period of four years" (Jones, 1995, p.140). The final partnership agreement was signed on 7 January; however, shortly thereafter, the proposed merger was terminated, as Edgar Jones suggests, probably through the efforts of Sir Albert Wyon, the senior Price Waterhouse partner (Jones, 1995, pp.139-42).
12. KMG Main Hurdman was created in 1979 by a merger of the US firm of Main Hurdman & Cranstoun and nine independent firms including Deutsche Treuhand-Gesellschaft (West Germany), Klynveld Kraayenhof & Co. (Netherlands), Thomson McLintock & Co. (Britain), Thorne Riddell & Co. (Canada) and Hancock & Offner (Australia) (*The Wall Street Journal*, 26 July 1979b, p.32). Earlier in

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1979, Main Hurdman & Cranstoun had been created when Main Lafrentz & Co. merged with Hurdman & Cranstoun (Cole, 1979, p.D3). Further illustrating the intricacies of mergers, Main Lafrentz resulted from the merger of Main & Co. with F. W. Lafrentz & Co., which was founded in 1899 as The American Audit Company (*A Half Century of Accounting*, 1949, p.10).

13. In 1989, Edward A. Kangas emphasised that the globalisation of its clients was the major reason for the merger. In a 1997 article in *Chief Executive*, Kangas reiterated that position when he wrote: "We were not going to achieve our objectives unless we came to terms with globalization. A firm our size simply did not have the capabilities to serve clients in several key overseas markets. We had to merge" (Kangas, 1997, p.33).
14. Several economists have questioned the likelihood of greater economies of scale in horizontal mergers such as the proposed merger between Price Waterhouse and Arthur Andersen. For example, Scherer (1980, p.546) writes: "an impressive accumulation of evidence points to the conclusion that mergers seldom yield substantial cost savings, real or pecuniary".
15. In their news release, Coopers & Lybrand and Price Waterhouse stated their combined revenues would approach $13 billion for fiscal 1997. Worldwide revenues for Coopers & Lybrand and Price Waterhouse in 1996 were $6.8 and $5.02 billion, respectively. In the US, the two firms reported revenues of $2.12 and $2.02 billion, respectively (*Public Accounting Report*, 1997b, pp.1 and 5).
16. Shortly before the firm's problems with Enron arose, Joseph A. Tarantino, a partner with (Arthur) Andersen, was interviewed in the *Review of Business*. In the interview (Caso, 2002, pp.6-9), Tarantino commented on the need for the international growth of the firm and the new services provided. Tarantino stated: "Growth is always desirable, but this direction of growth has been predominantly market driven. We have become a Professional Services firm because of the needs of our clients. And all of these services are international in scope".

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