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Perera, Hector B;Rahman, Asheq R;Cahan, Steven F
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HECTOR B. PERERA, ASHEQ R. RAHMAN AND STEVEN F. CAHAN

GLOBALISATION AND THE MAJOR ACCOUNTING FIRMS

Driven mainly by deregulation and technological change, globalisation is a common tendency among firms seeking better opportunities and lower costs. This paper discusses the nature of globalisation in accounting firms, in particular the "Big 5" (the paper was written before the Big 5 became the Big 4). The firms seem to exhibit two forms of the phenomenon: establishment globalisation (spread of a firm's establishments in different locations) and product globalisation (addition of new services in a bid to extend global reach). The paper examines the effect of globalisation on the demand for accounting information and how globalisation transforms the major accounting firms.

While globalisation can be defined in various ways (eg, see Higgott and Reich 1998), we see it as the international integration of production and markets. The trend is not new (Bentley 1996 traces globalisation back to Columbus's discovery of America in 1492 and de Gama's voyage around the cape of Africa to India in 1498),[1] but it has accelerated in the past decade or so as a result of two catalysts – deregulation and technological advances.

The key feature that underlies the concept of globalisation is the erosion and irrelevance of national boundaries in markets.[2] For example, the securities markets of various countries are becoming integrated into a global system through cross-border transactions and listings and the increase in the number of multinational fund managers. The meaning of globalisation of the securities markets was highlighted in October 1987, when a major correction in the American market almost immediately affected other markets around the world (eg, see Smith 1990). The experience of the Asian currency crisis of 1997-98, when the problems of a few countries subsequently spread to many others, further signifies the global character of the financial markets.

Although national regulators have sovereignty over the movements of capital across their national boundaries, the rapid integration of financial markets renders such sovereignty ineffectual. The global mobility of production facilities limits the ability of governments to impose capital controls, and recent attempts to do so through taxes and regulations have had negative impacts on capital markets (Feldstein 2000). Further, the electronic movement of capital is creating a new form of market that exists in microprocessors and cyberspace, and not necessarily in a geographical location. In addition, because of their multiple locations, the nationality of global firms may be difficult to ascertain, raising questions about regulatory jurisdiction. Cross-border mergers and alliances will only accentuate this trend.

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TABLE 1: CROSS-BORDER TRANSACTIONS IN BONDS AND EQUITIES AS A PERCENTAGE OF GROSS DOMESTIC PRODUCT (GDP)[a]								
	1975	1980	1985	1990	1995	1997	1998	1999
United States	4	9	35	89	135	213	230	179
Japan	2	8	62	119	65	96	91	85
Germany	5	7	33	57	172	253	334	334
France	–	5	21	54	187	313	415	NA
Italy	1	1	4	27	253	672	640	NA
Canada	3	9	27	65	189	358	331	NA

[a] Gross purchases and sales of securities between residents and non-residents.
Source: Bank of International Settlements, 31 March 2000, http://www.bis.org/publ/ar2000e5.pdf

TABLE 2: CROSS-BORDER LISTINGS

	Domestic equity		Number of new companies listed during 1998			Total number of companies listed at 31 December 1998		
Exchange	Market value (£m)	Turnover (£m)	Domestic	Foreign	Foreign%	Domestic	Foreign	Foreign%
American	80,499	173,055	78	11	12.36	708	62	8.05
Australian	197,889	97,459	56	7	11.11	1,162	60	4.91
Brussels	147,106	39,396	30	6	16.67	155	139	47.28
Irish[a]	40,025	28,277	3	3	50.00	79	21	21.00
Hong Kong	206,504	123,898	31	1	3.13	665	15	2.21
Italian	339,536	300,074	22	1	4.35	239	4	1.65
London[b]	1,426,900	1,796,014	199	34	14.59	2,399	522	17.87
Luxembourg	22,946	748	2	11	84.62	53	224	80.87
Madrid	208,363	404,956	111	1	0.89	474	5	1.04
Nasdaq	1,562,688	3,485,996	404	50	11.01	4,627	441	8.70
New York	6,529,931	4,398,305	185	43	18.86	2,722	392	12.59
Oslo	27,901	25,457	28	2	6.67	214	22	9.32
Paris	589,096	367,798	119	8	6.30	784	178	18.50
Stockholm	167,518	135,729	33	3	8.33	258	18	6.52
Tokyo	1,466,295	519,421	54	3	5.26	1,838	52	2.75
Toronto	326,611	193,000	113	3	2.59	1,384	49	3.42
Viennaa	20,500	10,684	2	1	33.33	96	32	25.00

a Turnover has been halved for comparison purposes
b London figures have been halved for comparison purposes for non-SETS trading
Source: London Stock Exchange http://www.londonstockexchange.com/stats/stats.asp

While the term "globalisation" is often used in abstract, evidence of its existence is not hard to find. An integral part of the process of globalisation is the large increase in cross-border investments. Table 1 shows the growth in cross-border transactions in bonds and equities between 1975 and 1999. The scale and the freedom with which these transactions occur have accelerated the process of creating a single global market.

Cross-border listings are another common and growing phenomenon (see Table 2). In particular, the US stock exchanges have a higher proportion of foreign firms among their newly listed firms than in the pre-1998 years. In addition, the value of cross-border mergers and acquisitions in the first half of 2000 rose by 60% to an all-time high of $643 billion (KPMG 2000).[3]

Not surprisingly, globalisation is transforming the accounting environment. A visit to the website of each of the Big-5 accounting firms shows that all of them embrace globalisation in one way or another. This paper examines the reasons and implications. We focus on the Big-5 firms because, as a result of their size and reach, they are most exposed to the forces of globalisation. However, the lessons learned from the Big 5 can be applied to smaller accounting firms.

DRIVERS OF GLOBALISATION

A major factor contributing to the globalisation of markets has been the development of macroeconomic policies that emphasise economic liberalisation, such as the abolition of restrictions on international capital flows, privatisation of state enterprises and deregulation of financial markets. The liberalisation/deregulation movement in OECD countries and the drive in the European Union to eliminate barriers to free trade and investment have removed major impediments to a globally integrated economy.

The emergence of new political and economic structures also contributed greatly to the process of globalisation. They include the political structures resulting from the collapse of the Iron Curtain, the reunification of Germany, and the breakup of the USSR; the shift

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toward a market economy in the Soviet Union, its former satellites and in China; the passage of the Maastricht Treaty in Europe; and industrialisation in the Pacific Rim countries. The global political change that has followed the end of the cold war has made the world safer for foreign direct investments from industrialised countries. Additionally, the creation of the World Trade Organisation (WTO) in 1993, with the liberalisation of world trade as its main objective, has been significant in the globalisation process. Further, the deregulation of monetary controls – with the collapse of the Bretton Woods system and the shift to flexible exchange rates – has been an important driver of change in the international financial markets going back to the early 1970s.

A second important driver of change has been the revolution in micro-electronic and communication technologies (eg, Gundlach and Nunnenkamp 1996). Advances in satellite and fibre-optic technology have permitted global communications at high speed and low cost. The explosive growth of the Internet is changing the way businesses do business and the way consumers view businesses. For example, Evans and Wurster (1999) note that the Internet can reduce asymmetries that arise in information channels and can eliminate the trade-off between richness and reach that exists in traditional markets. More generally, the Internet is a disruptive technology. That is, doing business, and surviving, in a networked world requires a fundamental mind-shift on the part of managers (eg, Drucker *et al* 1997).

A FRAMEWORK FOR UNDERSTANDING THE EFFECTS OF GLOBALISATION

It is widely known that deregulation reduces barriers to entry, increases competition, and leads to more integrated markets. A significant by-product of market integration is that business transactions become more homogeneous: local differences in business practices and products are reduced or eliminated. Consequently, operating a software development company in the Silicon Valley is not significantly different from operating a software development company in Bangalore, India; the modes of raising funds are becoming similar in the US, Australia or Asia; and a single product, such as a particular model of car or PC, can be sold in multiple markets.

A result of homogenisation is that it is easier for accounting firms to develop functional specialties that can be sold in more than one market. For example, audit software can be standardised because internal control systems and accounting standards are becoming more similar across countries. Likewise, an accounting firm might develop and package e-business systems that can be sold as easily in Mexico as in Denmark. We call the ability to produce a single product or provide a service that could be sold in multiple countries *product globalisation*.

Technology is important because it can reduce costs and increase productivity (Whalen 2000) and open up new revenue streams. However, these factors by themselves do not mean that a firm will globalise because a firm could also benefit from technology by remaining in its domestic market.

Technology drives globalisation in several ways. First, technology makes it easier and less costly to share knowledge internationally, which is particularly important in knowledge-based industries. Second, technology increases the size of the market. With the Internet, a firm has access to a worldwide client pool. As a result, firms can pursue products that would not be profitable in their local market alone. Third, technology can reduce communication and coordination costs. This is important for firms that decide to establish a physical presence in multiple countries, a process we refer to as *establishment globalisation*.

A truly globalised firm will exhibit a high degree of *both* product globalisation and establishment globalisation, and while it is useful to identify these two streams separately, often they will develop simultaneously. Although deregulation and technology will not be the only factors affecting the decision to globalise (see Porter 1990, Rugman 1996, Buckley and Ghauri 1999 for more comprehensive discussions), they are critical factors.[4]

EFFECTS OF GLOBALISATION ON THE DEMAND FOR ACCOUNTING INFORMATION

Globalisation is affecting the type of accounting information demanded by users. Increased emphasis on the quality of accounting information, the nature of accounting standards and the appropriateness of the current accounting model will have an impact on the growth opportunities of accounting firms.

Global standard-setting

The move toward international accounting standards is a useful example of the concept of homogenisation. With markets around the world more interconnected than ever before through cross-border mergers, acquisitions and the growth of global firms, more investors are seeking access to foreign markets and more companies are seeking capital on a worldwide basis. In this context, the argument for one set of accounting principles, or a worldwide system of capital markets reporting standards (CAP-GAAP) becomes stronger (Jenkins 1999). Within the international business community there is now an expectation that accounting should transcend national boundaries and converge (Purvis *et al* 1991). It has been argued that global standards are not merely an ideal for a better global marketplace, they are fundamental to its existence (Levitt 1999b).

The International Organization for Securities Commissions (IOSCO) has been consistently supporting the idea of a set of good-quality accounting

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standards for cross-border listing. IOSCO (1998a) provides a broad framework for disclosure by firms listing internationally and sees efficient and effective disclosure as an integral part of good corporate governance (IOSCO 1998b). In May 2000, IOSCO recommended that its members allow multinational issuers to use 30 IASC core standards to prepare their financial statements for cross-border offerings and listings, as supplemented by reconciliation, disclosure and interpretation where necessary to address outstanding substantive issues at a national or regional level. This recommendation seems to offer the prospect of more relaxed US requirements for foreign filers on some issues (eg, the revaluation of assets), although there would be tighter requirements on others (eg, the consolidation of special-purpose entities).

Indeed, regulatory institutions in the US are showing more interest in letting the foreign listers use international accounting standards for listing in the US. A release of the SEC in 2000 (SEC 2000) sought views on this matter. It is indicative of the more relaxed attitude adopted recently by the US securities regulator towards the IASs. It could be a first step towards accepting the IASs or some form of global accounting standards by the US or an attempt of the US regulators to bring the US-GAAP and the IASs closer together.

The recently restructured IASC clearly reflects a change in its role, from a harmoniser to a global standard-setter. In January 2001, 23 international accounting firms, including the Big 5, met in London to launch an initiative to develop a global quality standard for auditing. This meeting was sponsored by IFAC in recognition of the effects of globalisation of business on accounting and auditing. These developments reflect a trend toward global standard-setting.

Need for a new accounting model

The valuation of dot-com firms, where firms with no accounting earnings and very little else, is often used to illustrate the shortcomings of traditional accounting information. For example, in late 1999, Amazon.com, an Internet bookseller with no accounting profits, had a market capitalisation of $30 billion, which far exceeded the capitalisation of Barnes & Noble, a more profitable, bricks-and-mortar retailer (although the latter does have a Web presence) (*The Economist* 2000a).

As Drucker *et al* (1997) explain, in the networked world, managers have to learn that their company is what people see it to be and that they must figure out how to turn that visibility to their advantage. This requires a fundamental change in the approach to information disclosure.

In the current environment, wealth creation places more emphasis on technology and knowledge than on physical assets. Unlike manufacturing inventories and buildings, the value of R&D invested in a software program, or the value of a worldwide user base of an Internet shopping site, is much harder to quantify. These shifts have created new challenges for accounting and auditing (eg, Levitt 1999a, Brown 1999/2000, Dyckman and Zeff 1999/2000, Moore 1999/2000).

The need for business reporting to respond to the information needs of users in the diverse and rapidly changing modern environment has been highlighted in recent reports by two professional accounting bodies, AICPA (1999) and CICA (1999). Both call for more information about the current values of various assets, including those not presently given much recognition in financial statements, such as intangible assets. For example, the CICA report says the features that should be considered in a financial reporting model include a move towards continuous reporting, increased user involvement in the design of accounting reports, an increasing tendency to include non-financial information in accounting reports, and a trend towards integration of internal and external reporting.

While academic research suggests accrual earnings are more relevant than other definitions of earnings (eg, Biddle *et al* 1997, Dhaliwal *et al* 1999, O'Hanlon and Pope 1999), there is also demand for other types of information (eg, information about intangibles, market values and non-financial information) and more timely information, and this demand will intensify as technology-driven businesses become more evenly spread around the globe (Lev and Zarowin 1999).

Already, the AICPA, in conjunction with the Big 5 and more than 50 companies, has been working on developing a single worldwide electronic business language, called XBRL (extensible business reporting language), which can be used to deliver reliable financial information over the Internet (Accounting Education 2000f). This example is instructive not only because it illustrates how technology is changing the way accounting information is delivered, but also because it shows how the profession and large accounting firms must take a leadership role if they are to have a significant influence on issues that directly affect them.[5]

GLOBALISATION AND THE BIG 5

Like all businesses, the Big-5 accounting firms have been affected by deregulation and technology. Having once derived nearly all their revenues from auditing, they now resemble diversified professional practices (Levitt 1999a). Between 1990 and 2001, their proportion of management consulting services revenues has increased significantly. In the same period, the proportion of revenues from auditing services has dropped (Levitt 1999a). Table 3 shows the changing pattern of the revenue sources of the Big-5 firms.

The shift toward non-audit services has three main causes. First, deregulation has led to the homogenisation of business transactions. As a result, audits – within the Big 5 – have become a commodity. This comment is meant to be broader than the similar point made earlier – that while harmonisation of accounting standards is one example of homogenisation, deregulation is also homogenising business transactions in

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TABLE 3: REVENUE SOURCES OF THE BIG-5 ACCOUNTING FIRMS

	Auditing %				Tax %				Consulting & others %			
Accounting firm	2001	1999	1994	1990	2001	1999	1994	1990	2001	1999	1994	1990
Arthur Andersen	43*	18.0	33.0	34.6	31*	12.0	18.0	21.6	26*	70.0	49.0	43.8
KPMG Peat Marwick	37	38.0	54.0	53.0	23	25.0	20.0	27.0	40	37.0	26.0	20.0
Ernst & Young	57**	34.0	49.0	53.0	39**	23.0	21.0	25.0	4**	43.0	30.0	22.0
Pricewaterhouse-Coopers	33	34.0	NA	NA	16	19.0	NA	NA	51	34.0	NA	NA
Coopers & Lybrand	NA	NA	58.0	60.0	NA	NA	18.0	20.0	NA	NA	24.0	20.0
Price Waterhouse	NA	NA	43.0	47.5	NA	NA	25.0	28.6	NA	NA	32.0	23.0
Deloitte & Touche	31	31.0	52.0	57.0	19	19.0	22.0	23.0	50	41.0	26.0	20.0

NA = Not applicable.

* After the separation of Andersen Consulting

** After the sale of the consulting arm to CAP Gemini Paris

Source: Public Accounting Reports 1995 1999 and 2001. http://www.straffordpub.com/products/acnatsrv/sample.pdf

general. This is mainly because firms are competing more in their core areas and are trying to achieve benefits through larger-scale production and marketing in a much bigger global domain. As a result, fewer products are produced and sold but production and marketing are on a larger scale. Homogenisation of transactions makes audits more standardised and, since product differentiation is by definition difficult to achieve with commodities, producers compete on price. To reduce costs, the Big 5 have increased their reliance on technology, such as improved audit software, but these gains are eroded through competition, leading to even more reliance on technology and a shift towards non-audit services, which are becoming increasingly attractive as revenue sources.

Second, the Big-5 firms have been attracted to the increasingly lucrative and commercial opportunities that have been created by globalisation, in the areas of general management, information technology, mergers and acquisitions and other consulting work. Some of these opportunities are the result of deregulation. For example, because markets are more similar, it is easier for Big-5 firms to develop functional specialties and products that can be marketed widely, transferring knowledge and expertise from one country to another. With access to a larger market, the firms can lower their per-unit costs for consulting services, resulting in higher margins. The use of intranets and knowledge databases enables Big-5 firms to reduce costs further by minimising transfer costs and by amortising the cost of acquiring the knowledge over a larger number of engagements. Technology also gives rise to new business opportunities. For example, the growth in e-business has given Big-5 firms the opportunity to provide advice on systems and strategy as well as providing assurance services and training (eg, see Accounting Education 1999a). In this way technology creates new markets for new services.

Third, deregulation and technology have decreased the costs of managing a firm. As deregulation homogenises business transactions, the differences between national partnerships in the Big-5 firms are minimised. With fewer national idiosyncrasies, the amount of knowledge that is specific to a particular country will decrease, and the amount of general knowledge will increase (see Jensen and Meckling 1995 for a discussion of general and specific knowledge). This reduces information asymmetries between the national offices and head office and makes it easier for the head office to coordinate and control activities of the entire organisation. Technology has also helped to reduce these transaction costs. Improved telecommunications allow for more interaction and better oversight at a minimal cost.

Mergers between the largest international accounting firms have been a major development since the 1980s, the latest being the merger in 1997 between Price Waterhouse and Coopers & Lybrand to form PricewaterhouseCoopers, reducing the Big 6 to the Big 5. These mergers can also be analysed in terms of deregulation and technology.

Deregulation has led to mergers not only between accounting firms. In the banking industry, mergers between BankAmerica and NationsBank, Banc One and First Chicago, Norwest and Wells Fargo, and UBS and Swiss Bank have resulted in some of the largest banks in the world. One recent merger between three Japanese banks – Fuji Bank, Dai-Ichi Kangyo Bank and Industrial Bank of Japan – has created the world's first trillion-dollar bank (Berger *et al* 2000).

Because of scale factors, these large organisations need large firms to audit them and, to some extent, large firms to provide them with consulting and other non-audit services. This requires that the accounting firm has both product reach (expertise in a number of different areas) and geographic reach (personnel in a number of different locations) (Kirsch *et al* 2000, Andon and Free 1999/2000).

In addition, deregulation is creating opportunities for consulting work in new markets in countries and regions that now have more favourable macroeconomic policies, such as India, Eastern Europe, former

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Soviet Union countries and China. These opportunities arise as a result of the measures taken in these countries to privatise state-owned enterprises, establish free-market pricing systems, relax import controls and reduce inflation. For example, in China, the movement for private ownership has required a revision of accounting and disclosure standards (Kirsch *et al* 2000). The merged accounting firms, because of their huge investments in both financial and human capital and their ability to spread risks, are in a better position to take advantage of these emerging opportunities.

Technology, too, is important in explaining the mergers of accounting firms. On the cost side, technology can increase efficiency and productivity, and it reduces communication and control costs, which become significant when merging two firms with distinct cultures and multinational operations (see *The Economist* 2000b) On the revenue side, technology creates new opportunities, and again the merged firms have the scale and scope to exploit these.

GLOBALISATION AND THE FUTURE OF THE BIG 5

From the Big-5 viewpoint, a shift toward global accounting standards is likely to decrease costs and revenues. Homogeneous standards will reduce the costs of doing an audit because audit systems and procedures can be standardised. At the same time, uniformity in accounting standards will accelerate the commoditisation of audits. That is, there are few discernable differences in audits or audit quality among the Big-5 firms, and removing differences in expertise with regard to local accounting standards will make audits within the Big 5 even more alike. Unable to differentiate their products, the Big 5 will be forced to cut prices, which will reduce revenues.

In broad terms, we expect the trend toward non-audit services will continue. Auditing will continue to be a low-margin activity because of standardisation and technology, and the Big 5 will continue to gravitate toward the higher-margin consulting work which will continue to grow because of further deregulation and new technological developments. However, because of regulatory concerns, we do not expect any further mergers between the Big-5 accounting firms; for example, the proposed merger between KPMG and Ernst & Young announced in 1997 was strongly opposed by European regulators for anti-competitive reasons (see Electronic Accountant 1998a, 1998b).[6]

However, the growth of the Big-5 firms in a globalised world is not assured.

Competition from other professions

The boundaries between accounting and other professions are becoming increasingly blurred. For example, a recent UK report on competition in professions advocates the removal of obstacles to forming multi-disciplinary practices.[7] The Big 5 are expanding into other business areas in their attempt to take advantage of the new opportunities created by globalisation. In doing so, they will be up against entrenched and formidable competitors (in addition to competition from the other Big-5 firms).

The new demands for corporate information create opportunities for the Big 5 and the profession to develop new products and services. However, many of the new demands can be satisfied by non-accountants. For example, valuers have expertise in assessing intangibles, systems experts are needed to provide the hardware and software capabilities for continuous reporting, and various specialists – in human resources, strategic planning, marketing, operations, or even public relations – are needed to provide the types of non-financial information that is likely to be required.

On the other hand, firms outside the accounting profession are, for similar reasons, starting to compete with accountants in the provision of traditional accounting services. For example, American Express and Merrill Lynch have each acquired several accounting practices (Melancon 1998). While these firms may not have the scale to threaten the Big 5 in the large audit market, they may pose a threat in the small audit market if they can produce audits of the same perceived quality at a lower cost. Whether these new entrants can compete may depend on whether they can transfer their brand images from their traditional products markets to their audit services.

In addition, moves to liberalise the accounting profession – eg, the mutual recognition agreements that are being developed under the General Agreement on Trade in Services (see Heeter 1999) – may make it easier for the new entrants to expand internationally by reducing barriers to entry.

Accepting the trend of globalisation of the accounting profession and the reduction of barriers between accounting and other professions, professional accounting bodies in Australia, Canada, New Zealand and the US have initiated a plan for a global professional designation focused on knowledge integration. Their plan envisages an educational qualification that will be portable from one country to another and broadly based, encompassing disciplines including accountancy, business law, information technology, engineering and business administration (The American Institute of Certified Public Accountants *et al* 2000). The proposed qualification, although still under consideration, has the support of a broad spectrum of members of the accounting bodies. Efforts such as this, if successful, could pose a threat to the global image of the Big-5 accounting firms as they encounter competition from a full profession which is also focused on establishment and product globalisation. However, the Big-5 firms would be well placed to deal with this threat by embracing this emerging profession and playing a leading role in the ensuing globalisation of professions.

The importance of brand management

The brand or reputation of the Big-5 firms will become even more important in the increasingly global environ-

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ment.[8] Because of mounting competition both in the audit and non-audit markets, the Big 5 need to differentiate themselves from their competitors. The announcement by Arthur Andersen in early March 2001 that it will henceforth be known as Andersen is an example of a brand differentiation strategy. The reason given for the name change was that using Andersen as their global brand would better align with their strategic commitment to continually enhance the breadth and depth of their capabilities.

DeAngelo (1981) argues that the large audit firms produce higher quality audits to protect their reputations, and in the future, the Big 5 will have to make significant real investments (eg, by hiring the best graduates, having the best systems, having the best training) to ensure this quality differential is maintained. This is particularly important as audits become commoditised.

However, it is also important for the Big 5 to maintain their brand in the audit market because they can use this brand to differentiate themselves in other product/service markets. To an extent, the Big 5 are already doing this as they expand their non-audit services. However, as the non-audit market becomes even more blurred and the Big 5 find themselves competing against non-traditional competitors (such as information technology companies), brands and reputations become more valuable.

Also, while audits will be providing less to the bottom-line, the audit market will remain central to the Big-5 firms. Because they have a virtual monopoly of the large audit market, the Big 5 have been able to use this market to build their brands.[9] This will continue to be the case as it will become more difficult to develop reputations in a non-audit market where they are competing against recognised competitors with their own brands (eg, McKinsey, Boston Consulting Group).

IN THIS COMPETITIVE ENVIRONMENT, THE BIG 5 NEED TO IDENTIFY AREAS WHERE THEY HAVE (OR CAN DEVELOP) SUFFICIENT EXPERTISE TO ESTABLISH A QUALITY DIFFERENTIAL OVER THEIR COMPETITORS.

Developing functional specialties or niches

While globalisation creates new opportunities, it also means more competition. In this competitive environment, the Big 5 need to identify areas where they have (or can develop) sufficient expertise to establish a quality differential over their competitors. This is preferable to resorting to price competition, which would be difficult because the Big 5 are likely to be high-cost producers (they hire the best graduates and have high overheads). Also, competing in areas that are price-driven is likely to diminish the value of their brands because they are likely to confuse customers (Porter 1980 warns companies not to get struck between the product differentiation and cost minimisation strategies) and because they are more likely to deliver substandard work in areas where they do not have adequate expertise.

As a result, the Big 5 will focus on developing functional specialties and should market these specialties in as many countries as possible.[10] In other words, they will aim for product and geographic globalisation. Where a Big-5 firm does not have expertise but is compelled to be in the market (perhaps to support its other services), it can buy the expertise (by merging with or acquiring a specialist firm), outsource the work, or form alliances.

Managing the expectations of stakeholders

Becoming more global also means becoming more visible. The Big-5 firms audit companies listed in numerous jurisdictions, and as these companies grow, the Big 5 are increasingly coming under the watchful eye of global financiers and regulatory institutions. For example, following the market crisis that emerged from Asia in 1997 and 1998, the World Bank asked the international accounting firms to refuse to give clean audit reports for financial statements that were not prepared in accordance with internationally acceptable accounting standards. More recently, commenting on the causes of the Asian financial crisis, Turner (2001) points to the failures of (a) company accounts to show billions of dollars of debt, allowing companies to continue borrowing with no hope of repayment and (b) auditing to detect the vulnerabilities.

Likewise, regulators and the public have high expectations of earnings management. In the globalisation debate, reference is often made to the importance of high-quality standards and transparency to the efficient operation of the capital market. Lately, there have been major concerns about the developing culture of "gamesmanship" over accounting numbers (Levitt 1999a, Gallhofer *et al* 1999/2000). The gamesmanship described here means, among other things, that it is acceptable for companies to bend the rules to satisfy the market analysts' earnings estimates. Auditors are coming under increasing pressure to identify and pre-

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vent such practices (Levitt 1999a), and they will increasingly be blamed when serious cases of earnings management are uncovered.

One might argue that some of these expectations are unrealistic. Corporate reporting is a complex process in which overall quality is determined by the interaction of many participants (accounting standard-setters, companies, regulators, auditors and investors/users). However, the expectations do exist. If the Big 5 believe they are unable to meet these expectations, they should work proactively with the stakeholders to set new ones. Failure to do so may lead to unwarranted criticism and an erosion of brand values.

Independence requirement under challenge

The change in the nature of the services provided by accounting firms is exerting pressure on regulators to relax the current independence requirements (Turner 1999). Reports of independence rule violations by major international accounting firms are appearing frequently. In January 2000, the SEC made public a report by an independent consultant who reviewed possible independence rule violations by one of the Big 5 arising from ownership of client-issued securities. The report reveals significant violations of the auditor independence rules of the firm, the profession and the SEC (Accounting Education 2000b).[11]

Auditor independence in the traditional sense is becoming increasingly problematic as both the audit firms and their clients grow in size and complexity. While the SEC has recently proposed more stringent independence standards, including some restrictions on the delivery of audit and non-audit services to the same client, the Big 5 need to ensure that they are independent both in fact and in perception (see Accounting Education 2000e). This is critical because a lack of independence, real or otherwise, will reduce the quality premium of the Big 5 and will open the audit market to more competition.

The Big 5 might consider more drastic action, eg, splitting into separate entities, each dealing with a specific operational area. This would allow auditing and consulting arms to deal with the same customer (eg, *Straits Times* 2000). Indeed, in March 2000, Ernst & Young announced the sale of its management-consulting business to CAP Gemini Group SA for around $11 billion. One reason was to reduce SEC concerns about lack of independence (Accounting Education 2000a, 2000c). Also, PricewaterhouseCoopers recently decided to separate its audit and business advisory services from its other businesses in a decision that was "encouraged" by the SEC's investigation and proposed rule changes (Accounting Education 2000d). This raises the issue of how the Big 5 should be owned and organised.

Ownership and control structures

Globalisation has put pressure on the ownership and control structures of international accounting firms. For example, the development of multidisciplinary service firms in order to meet the clients' needs at the global level requires large amounts of additional funding and may in turn require access to capital markets. This is not possible under the traditional partnership model (Hoiberg 1999/2000). Also, traditionally partners in audit firms have had joint and several liability for the obligations of the partnership. However, with the globalisation-driven growth in the types and value of activities provided by the Big 5[12] and the continuing spectre of litigation, the joint and several liability feature is a significant weakness of the partnership form of ownership.

Not surprisingly, the Big-5 firms have been exploring alternative ownership structures. For example, KPMG in February 2000 announced the incorporation of KPMG Consulting, owned by KPMG LLP and its partners (80.1%), and Cisco Systems Inc. (19.9%) which in August 1999 agreed to invest $1 billion.[13] In addition, the Big-5 firms are using limited liability partnerships, where permitted by law, to reduce their exposure to litigation.

Two additional problems of the partnership form of organisation are that it can slow decision-making and that it can lead to an overly conservative entity. Because partnerships spread ownership more or less evenly among all the partners, significant decisions are often made democratically. This requires consensus-building, which can be a slow and resource-consuming process. It can also be divisive because of national and regional differences that may exist within partnerships.[14] Likewise, because each partner may have most of his/her wealth tied up in the partnership, partnerships can be highly risk-averse organisations in a marketplace where the biggest benefits accrue to those that are nimble enough to respond quickly to new opportunities and are willing to take risks.

Tomorrow's Big-5 firm may, in fact, be more like alliances where a group of relatively autonomous sub-entities are held together by a strong central core. Each sub-entity would be focused on a functional specialty/product or geographic region, and each would have a unique ownership and organisational structure (not necessarily a partnership) depending on its market and risks. This would allow the firm to move the initiation and implementation functions to areas with appropriate expertise. The head office's role would be to coordinate the activities and ensure the maintenance of brand image by the sub-entities. Thus, its functions would include setting firm-wide strategies, promoting synergies, creating appropriate incentives, monitoring performance and ensuring quality.

To an extent, the Big 5 are already recognising the need to change traditional ownership and control structures. In addition to the PWC split, Deloitte Touche Tohmatsu recently realigned its functions, products and services on a global basis to realise efficiencies and increase cross-selling opportunities (Deloitte Touche Tohmatsu 1999). However, if the Big-5 firms want to exploit all the opportunities available to them, these moves will have to go even further.

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Deficiencies in the accounting model

It is clear that there are deficiencies in the current historical-cost-based accounting model. While it is not our purpose to propose solutions, it is worth noting that in one important area, intangibles, the accounting profession appears to be slow in adopting change. Intangibles are critically important as value-creators in a globalised, technology-driven world. Academic research (eg, Barth and Clinch 1998) indicates that information about intangibles is relevant in valuing firms.

While the reform of the accounting model is a professional issue, the Big-5 firms make up a significant part of the profession. These firms have the most to lose if the value of traditional financial statements is diminished, because this would also devalue the audit process. While some of the Big 5 market versions of the balanced scorecard which highlight non-financial measures (PricewaterhouseCoopers 2000), more work needs to be done, and the firms need to take a more proactive leadership role in addressing wider concerns about the accounting model.

CONCLUSION

This paper highlights how globalisation is affecting and will affect the Big-5 accounting firms. While we focus on the Big 5, our discussion has implications for smaller accounting firms. Deregulation and technology also open up new markets for the non-Big-5 accounting firms. In fact, the impact of these two factors is likely to be proportionally larger for smaller accounting firms than for Big-5 firms. For example, with the Internet, a small accounting firm in a rural area of New Zealand or Australia theoretically has access to a worldwide market. This increases its market exponentially, whereas the increase for Big-5 firms is relatively less because they already have a physical presence around the globe. Whether this will benefit smaller accounting firms depends on their ability to develop functional specialties that can be marketed outside their domestic markets. Because of limited financial and human resources, smaller accounting firms will have to specialise in narrowly defined niches if they are to develop the expertise needed to provide a high-quality service or product. Thus, a small accounting firm might specialise in specific areas such as implementing balanced scorecards in hospitals or developing on-line ordering systems for dairy equipment manufacturers. Another way forward for smaller accounting firms is for them to join in alliances or form teams with other providers or to work as a subcontractor.

Given the importance of the globalisation issue, it would be useful to examine its impact on other segments of the accounting community – standard-setters, the professional bodies, mid-tier and small accounting firms, regulators and accounting educators. We hope the views expressed in this paper will be part of a wider discussion.

Hector Perera and Steven Cahan are professors at Massey University, New Zealand. Asheq Rahman is an associate professor at Nanyang Technological University, Singapore. *The authors acknowledge helpful comments on earlier versions of this paper by seminar participants at Massey University and Canterbury University, participants at the Asian Academic Accounting Association inaugural world conference in Singapore and the Twelfth Asia-Pacific Conference on International Accounting Issues in Beijing, and two anonymous reviewers, and research assistance by Sim Loo.*

NOTES

1 Also see O'Rourke and Williamson (2000).

2 While we limit our discussion to globalisation of business, globalisation is occurring in other areas as well, such as culture, values and language. For example, some view globalisation as the hegemony of American values (see Higgott and Reich 1998). However, it is worth noting the two are likely to be interrelated and reinforcing. That is, globalisation in the wider social environment will contribute to a commonality of demand for products and services.

3 This amount included 99 deals valued in excess of $1 billion (up from 55 in 1999) and included Vodafone's $186 billion bid for Mannesmann, the largest cross-border deal at the time (KPMG 2000).

4 For example, according to Porter (1990), country-specific intra-industry competition, input conditions, demand conditions, and characteristics of related and supporting industries will affect the decision whether to locate in a particular foreign country or location. Deregulation and technology can also affect these factors.

5 For more on Internet reporting, see, for example, FASB (2000) and Lymer *et al* (1999).

6 In addition, a survey by Deloitte & Touche found that 69% of chief executives and senior financial officers of multinational companies in 11 countries were against the proposed KPMG-Ernst & Young merger.

7 See Accounting Education (2001b).

8 Whittington (1999/2000) also makes this point but from a slightly different perspective.

9 The Big-5 firms audit the world's largest 100 companies, with market capitalisation ranging from $US31 billion to $273 billion (see http://www.iasc.org.uk/frame/cen1_9.htm).

10 As an example, Ernst & Young recently eliminated 400 consulting positions in an effort to move away from traditional consulting areas in order to further specialise in e-business (Accounting Education 1999b).

11 The full report is available at http://www.sec.gov/pdf/pwclaw.pdf.

12 For example, KPMG UK in its 1999 annual report announced its third successive year of double-digit growth with fee income exceeding £1

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billion in 1998/99, driven by strong growth in consulting and financial advisory services (http://www.kpmg.co.uk/kpmg/uk/about/annual/index.html).

13 The new entity comprises KPMG consulting operations in the US and Mexico. Its consulting operations in Asia, Latin America and Canada are expected to join the new entity at a later date.

14 For example, US partners of KPMG and Ernst & Young blamed their European counterparts for not supporting the merger between the two firms.

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