

## **The Strategy Problem of the Medium-Sized Accounting Firm**

by

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*The article reports the results of a case-study of a medium-sized accounting firm (MSAF) and two associated surveys. It argues that, based on this evidence and that of other relevant surveys, MSAFs must adopt a planned strategy of 'dynamic stability'. MSAFs face increasing competition for their largest clients from a few very large accounting firms. This competition is probably irresistible. The article examines the problems of the proposed strategy and, based on the available evidence, concludes that 'dynamic stability' is feasible, and offers some guidance on its implementation.*

### INTRODUCTION

The problems of the medium-sized firm in the financial services market have recently been highlighted by the merger of Armitage and Norton with Peat Marwick. If a 'large medium' firm such as Armitage and Norton is unable to remain independent, what hope is there for the 'small medium' firm of 10–20 partners? This article examines the plight of such firms in the market for accountancy and related services. It is based on evidence from a case-study of one such firm in the North West of England, backed up by two surveys, and also draws upon the evidence of other published surveys. The article concludes that medium-sized accounting firms (MSAFs) need to gear themselves for an expected and planned turnover of clients (and staff). Attention is also drawn to the particular problems faced by the MSAF in attempting a strategic review of its activities.

Accounting firms provide financial services primarily to businesses, though they also do a small amount of personal business, generally for the more affluent. The traditional core of their business has been auditing, taxation advice and preparation of accounts. However, this range of services has steadily expanded to include various types of consultancy, record-keeping and even insurance broking and deposit taking. The industry includes a large number of firms [Briston and Kedslie, 1985, quote 15,000], but it is dominated by eight very large firms.

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Our study begins by outlining the market situation in which firms find themselves. It is suggested that this implies a strategy of 'dynamic stability' with large clients regularly leaving the MSAF and new smaller clients taking their place. We then examine whether such a strategy is feasible and what are its implications. First, we examine the needs of clients and whether they are prepared to change firms and if so, for what. Second, we examine how clients are to be attracted to a particular MSAF and conclude that a policy of 'dynamic stability' is feasible and would meet the firms' objectives identified in our case-study.

We do not purport to spell out all the steps of a full strategic view for an MSAF. The elements of this are well described in Forsyth and Senton [1983] and would require a much longer treatment than available here. We do, however, offer some suggestions relevant to the design of a policy to carry out the proposed strategy.

The firm which was studied falls in the 10–20 partner range and is located within a medium-sized industrial conurbation. The case-study involved intensive interviews with all partners followed by two mail surveys; one covering 103 clients, the other, 190 business advisers in the areas in which the firm operates. Response rates of 53 per cent (55 clients) and 43 per cent (82 business advisers) were obtained. The results are compared with evidence from surveys conducted by Gibbs [1984], Hinds [1986] and Watkins and Wright [1986].

#### THE GENERAL MARKET SITUATION

The bread-and-butter work of accountancy firms is auditing, taxation and preparation of accounts. The market for these services is static or declining [Forsyth and Senton, 1983] and the expected standards of performance are increasing. At the same time clients are taking an increasingly hard line over the level of audit fees, with large companies even going out to tender. Firms of all sizes find it difficult to get clients to accept fees based on standard billing rates, and this was reflected in our case-study. These factors have caused the large firms to seek volume to cover their high overheads which are caused by increased service specialisation and range. They are actively seeking smaller clients. Most of these are currently served by medium-sized firms, and this has caused increased competition among the MSAFs themselves for the remaining clients. This trend is reflected in the statistics quoted in Briston and Kedslie [1985].

The basic dilemma of the MSAF is that it has to compete for clients not only with similarly sized firms in its area, but also with large firms and small firms. Small firms offer lower charging rates and more personal service, while large firms offer prestige, larger range and higher levels of specialised services.

In order to try to retain their larger clients, MSAFs have tended to widen their service range, but this increases problems of staffing specialisation and under-utilisation, and also brings them into competition

with other specialists. Indeed, even in the core areas, banks and solicitors may offer competition.

Given this combination of factors, together with the progressive removal of barriers to competition in this market, MSAFs are understandably nervous about whether they will be able to survive in the future.

#### DYNAMIC STABILITY – A FEASIBLE MARKETING STRATEGY

The process of concentration of large clients in large firms of accountants has been demonstrated by Briston and Kedsle [1985]. Watkins and Wright [1986] review the literature on auditor change and suggest that the main factor in this drift is pressure from banks, financial institutions and international agencies that large companies should have large, prestigious international firms of auditors. The prestigious firm may also make the raising of finance easier. Finally, there is a clear need for a large company operating internationally to be serviced by a large firm of accountants, with large manpower and an international network of offices. These factors are most relevant to the largest companies. However, all quoted companies and even USM companies appear to reflect the pattern of concentration in large firms of accountants. Thus these factors can be assumed to be influential for even large/medium-sized clients.

Apart from a voluntary change of accountants, clients may also change firms because of mergers, takeovers and group pressure. These processes are also likely to work against the MSAF. Finally, the MSAF can expect to lose clients due to liquidations, bankruptcy and retirement.

It would appear that, given the attractions listed above, the MSAF cannot hope to compete with very large firms. It must therefore reconcile itself to eventually losing its largest and most dynamic clients. While this may not be a frequent occurrence, each time it occurs it will leave a major 'hole' in the MSAF's portfolio. Clearly the MSAF cannot hope to replace a large client with other clients of the same size (unless perhaps they are failing companies). Thus it must look to fill the gap by acquiring smaller clients, by the growth of existing clients and by the growth of the services sold to them.

In the course of our interviews with partners of the MSAF which was the focus of our study, we attempted to elicit the objectives which the firm wished to pursue. This process turned out to be extremely difficult and revealed that most partners had not given the matter previous consideration, despite being very concerned about appropriate strategies for the firm's survival. The responses revealed a lack of communication between partners and uncovered a number of unrecognised conflicts. However, we eventually identified a consensus objective. The partners did not seek growth of the firm in terms of number of clients, total workload, number of partners or number of staff. They were concerned to survive and to increase earnings for the present level of work. However, they were quite prepared to contemplate *change* in clients, in mix of services provided, and in staff.

We do not suggest that this objective would apply to all MSAFs. However, the factors leading the partners in our sample firm to this conclusion are likely to apply in many MSAFs.

In the market situation of the MSAF, a continual loss of large clients and gain of smaller clients seems essential for survival. Given the objective outlined above, this implies an approximate balancing of the two flows. However, if an MSAF actively sought growth, this would imply an excess of inflows over outflows.

We conclude that a policy of 'dynamic stability' is required for the survival of the MSAF and we now examine whether this is feasible and if so, how it should be carried out.

#### CLIENT WILLINGNESS TO MOVE

A strategy of dynamic stability will only be feasible if the MSAF is able to attract new clients and retain them until they graduate to a larger firm. This raises the question whether potential clients are willing to change firms of accountants, and if so, what will induce them to do so. If it appears that clients can be induced to move, the MSAF needs to design its marketing mix to meet clients' requirements so that they will come and will stay. We therefore begin by examining what services clients want from their accountants and then go on to see whether and why they move.

Our survey examined the present use of services and clients' anticipated need for other services. We asked what services were currently used, which services they were aware of, which services not currently used they might use in the future, and which services not currently provided by the firm they would have liked to use in the future. The survey divided respondents into unquoted companies, partnerships and sole traders. The sample could of course be biased as it consists of clients of one MSAF. However, our results are consistent with those obtained by Gibbs [1984] and Watkins and Wright [1986].

Different patterns were revealed by the three classes of respondents (see Table 1) with smaller clients making greater use of accountancy services and larger clients making more use of auditing and taxation. The predominant role of these services is reflected in the much lower rates of usage of other services. The potential usage of additional services from among those already provided is shown in Table 2. Further services likely to be required by respondents were very varied and often suggested by only one respondent. They included business planning (three respondents) debt collection (one) and leasing (one). This evidence can be compared with Gibb's [1984] survey result that medium-sized clients particularly wanted accountants to keep a watchful eye on their business interests and were dissatisfied at not having this.

The evidence indicates that the clients currently serviced by the MSAF still require primarily the three core services, backed up by general watchful business advice. There does not appear to be evidence of a great need for a very wide range of services. It would appear that MSAFs already offer

TABLE 1  
PROPORTION OF RESPONDING CLIENTS USING DIFFERENT SERVICES PROVIDED BY THE FIRM

Category of Client	Accountancy	Audit	Tax	Insolvency	Trust	Insurance broking	Company Secretarial Services	Consultancy
	%	%	%	%	%	%	%	%
Small Business	100	47	89	-	-	26	5	5
Partnership	100	67	100	-	7	27	-	7
Unquoted Company	90	100	100	10	-	19	10	28
Total	96	72	96	4	2	24	5	16

TABLE 2  
PROPORTION OF RESPONDING CLIENTS WHO ANTICIPATED FUTURE USE OF SERVICES CURRENTLY PROVIDED BY THE FIRM BUT NOT CURRENTLY USED BY THE CLIENT

Category of Client	Accountancy	Audit	Tax	Insolvency	Trust	Insurance Broking	Company Secretarial Services	Consultancy Management	Computer
	%	%	%	%	%	%	%	%	%
Small Business	-	-	-	-	26	47	-	21	21
Partnership	-	-	-	-	27	27	-	-	7
Unquoted Company	-	-	-	14	38	29	14	5	19
Total	-	-	-	5	31	35	5	9	16

the *range* of services necessary to attract and hold their clients. Therefore, in designing their marketing plan they can focus on other issues, such as quality of services, promotion, location and price. It is these factors which will permit the MSAF to attract new clients.

But will the clients move? This is a crucial issue for the MSAF and research evidence on it is not clear. Watkins and Wright [1986] suggest that movement is 'small' (about 5 per cent of clients per annum) and Hind [1986] found only 15 per cent in five years.

Reasons for changing accountants are often such that MSAFs can only lose by them, e.g., large clients moving to larger firms for prestige, international coverage, resources and services available. Change may also be due to corporate takeovers and mergers. These factors accounted for 14 out of 34 changes in Watkins and Wright's [1986] survey. Fee levels, better service, and personality factors accounted for 17 out of 34 changes (50 per cent) and 'location' accounted for the remaining 11 per cent. These categorisations are rather broad, and the exact nature of the cause is not always clear. However, it appears that 60 per cent of changes could be influenced by marketing activity of the firm. The evidence in Wright and Watkins relates to change of auditor and it may not be a good indicator of movement among smaller clients.

Our own survey evidence indicated that different types of client were sensitive to different factors. The largest clients were most sensitive to quality and range of services offered, partnerships were more sensitive to fee levels, and small clients were equally sensitive to price and quality. It might be surmised that the meaning of 'quality of service' would differ according to different sizes of client, with helpful personal attention being uppermost in the mind of small clients and expertise more important for companies.

The actual changes in past years may not be a good indication of the possible level of changes in the future under the impact of deregulation and increased competitive activity. While Wright and Watkins' survey suggested that only seven per cent of respondents felt they were likely to change accountants in the foreseeable future, we found that 86 per cent of our sample were prepared to specify circumstances in which they would consider changing accountants. Gibbs' survey also showed 79 per cent who would contemplate changing, with smaller clients more ready to contemplate change than large ones. However, Hind [1986] in a survey of 40 small to medium-sized industrial organisations in the north of England found that only five per cent of respondents professed themselves dissatisfied with their accountants, and although 44 per cent were 'very satisfied', 40 per cent were prepared to state reasons for dissatisfaction. We can probably conclude, therefore, that while actual change of accountants is not very great, potential for change may be substantial.

One reason why this potential is not being realised at present is almost certainly that clients have little knowledge of other accountants, or of the services which they provide. If this information was made clear to them, as could well happen with deregulation and increasing competition, the level of change might increase dramatically.



This raises the question 'How are clients drawn to a particular firm?' The overwhelming evidence is that, in the financial services industry, this is by personal contact. This is borne out by the results of our survey which showed that clients had come to the firm because of friendship with a partner (20 per cent), recommendation from a business colleague (32 per cent) or from the suggestion of a business adviser (20 per cent). The proportions were similar for all sizes of client. However, these results relate to the past when no other source of information about accounting firms was available. The results are supported by the evidence of other surveys, but one should beware of assuming that this will continue to apply in the future.

Of course, the point at which a business is most amenable to direction towards a firm of accountants is at its inception or at some significant discontinuity in its life. Thus an important element of an MSAF's client recruitment strategy could be directed to this issue. The above discussion has focused particularly upon existing businesses which already have their own accountant. However, the same principles apply to firms facing a discontinuity.

Typical discontinuity situations are: setting up in business, merging, entering into partnership, relocation, acquisition of new enlarged facilities, incorporation, computerisation, as well as bankruptcy, liquidation, fraud, prosecution and adoption of a scheme of arrangement with creditors. Early warning of the occurrence of these events could be valuable in ensuring that an MSAF is 'first on the doorstep'. This may well involve problems with current restrictions on promotional methods, though these restrictions may well ease in the future. However, other professional advisers, particularly banks, solicitors and estate agents, are likely to be involved in the planning or treatment of these situations, and they could provide valuable information and (more important still) recommendations about which firm of accountants the client should turn to. Of course, not all businesses meeting these discontinuities are desirable clients for an MSAF, but at least they provide a source of available clients from which the MSAF could choose those most compatible with its overall strategy. This would generally mean those in growth industries or with prospects of growth due to proprietor ability or market opportunities.

#### THE ROLE OF BUSINESS ADVISERS

If MSAFs are to aim for 'dynamic stability', i.e., continually losing and gaining clients, they need to establish a policy which will ensure that they do acquire replacement clients as clients leave them.

We examined the way in which present clients had come to the MSAF. The results are shown in Table 3. As was suggested above, this pattern relates to conditions in the past and will not necessarily continue to apply in the future. One might also wonder about the reliability of respondents' recollection or interpretation of how they came to the firm. The data suggest that around one third of clients had been influenced by business advisers. We therefore examined their role.

TABLE 3  
PRESENT CLIENTS' SOURCE OF IMPETUS TOWARDS FIRM  
(Percentage of responding clients)

<i>Category of Client</i>	<i>Bank</i>	<i>Solicitor</i>	<i>Insurance Broker</i>	<i>Business Colleague</i>	<i>Chamber of Commerce</i>	<i>Takeover</i>	<i>Partner of Firm</i>	<i>Other</i>
	%	%	%	%	%	%	%	%
Small Business	21	21	—	37	—	5	16	—
Partnership	13	13	7	33	—	7	20	7
Unquoted Company	19	5	10	28	5	—	23	10
Total	18	13	5	32	2	4	20	6

From 190 questionnaires sent out to business advisers in the areas serviced by the MSAF we obtained 82 usable replies, a response rate of 43 per cent. It almost appeared that business advisers wished to have the opportunity of publicly asserting their fairmindedness in making recommendations. We wished to find out whether advisers had an extensive body of knowledge of firms in the area and of the range and quality of their services. We also wanted to discover how business advisers evaluated firms and what was their policy in recommending them (e.g., providing a list or suggesting one firm).

The evidence suggested that, although most advisers know at least the names of most local firms, they frequently know very little more about them. The majority made recommendations rather infrequently and claimed to recommend more than one firm. In reply to a question about the way in which they gained their knowledge of firms, the commonest response was 'through comments of business clients', followed by 'social contacts with partners'. These two were not of course mutually exclusive. The primary criterion for recommending a firm was claimed to be either knowledge of a firm's reputation or personal knowledge of the firm. Knowledge of the range and quality of its services was not highly rated.

Our results can be compared with those obtained by Watkins and Wright [1986] who found 'past knowledge' of the firm, business advisers' knowledge, and clients' recommendations to be most highly rated as likely sources of information. They examined criteria for recommending a firm in more detail than we did and found quality of service to rank highest, followed by personal knowledge and previous experience. Cost of service came below both range of services and specialist expertise as a relevant factor.

One must confess that neither our survey nor that of Watkins and Wright delves as deeply as one could wish into the knowledge and motivation of business advisers. However, the general picture appears to be one of distinctly incomplete knowledge and reliance on a general 'feel' for a firm's reputation. Most advisers claimed to use a number of firms, although,



given the sources of knowledge, one might expect personal or business relations to be of primary importance. As one might expect, cost was not uppermost in their minds (even assuming they had any knowledge of relative costs). An adviser must always be open to a charge of having given bad advice, so it is natural to place stress on quality of service and a known track record.

#### MARKET STRUCTURE

We have not attempted to specify in detail the characteristics of the market segment which the MSAF should target, except to indicate that it would exclude large companies. In addition, as a dynamic strategy is envisaged, it is desirable to aim for businesses with growth potential. Apart from this, each MSAF will need to examine the market potential of its own geographical area of operations. This turns out to be no easy matter, as we found in the case-study. Government statistics are of some, but limited, value, and directories are generally a laborious way of gathering information and do not provide the kind of data required. However, these data are required most at the planning stage, and MSAFs may know the types of trade which exist in their area, their growth or decline characteristics and the size and geographical distribution of units, all in sufficient detail to formulate a general strategy and even to target particular individuals.

On the supply side, we found the partners of the firm under study to be very well informed about who their competitors were, though this may vary depending upon the size of conurbation in which the MSAF operates: it could be very difficult in London.

#### THE MARKETING PLAN

We have concluded so far that MSAFs need to accept a regular pattern of gaining smaller clients and losing larger clients. They are probably already providing the services required by the small/medium type of client on whom they currently concentrate, and while client movement has been fairly small in the past, it can realistically be expected to increase considerably in the future. In any case, it may require only a small, steady flow of new clients to compensate for the intermittent loss of individual large clients. We have also examined what it is that influences clients in selecting a firm of accountants and how the business adviser fits into this process.

Our purpose here is to examine the strategic dilemma of the MSAF in the light of the available evidence and to propose a strategy of dynamic stability as both desirable and feasible. We do not pretend to spell out in detail the implications of this for the marketing mix of the individual MSAF. However, there are certain points which arise from the research which are relevant to this decision.

The first issue is related to the *range and quality* of services provided. MSAF clients seem to be primarily concerned with the three core services, plus general financial and business advice. However, specialism is also a possible element of the MSAF's strategy and is not necessarily incompatible

with the above. It is feasible for a firm to offer, and become known for, a particular service, such as trust work, taxation advice or liquidation services, and to attract a supplementary clientele to these services. In addition, Gibbs' survey indicates that clients recognise and appreciate familiarity with their own industry. Thus a firm may choose to specialise in a particular industry or type of organisation, e.g., building societies or co-operative societies. Such specialism can extend outside the firm's usual geographical areas of operations. In addition, as the members of many industries have regular contact with each other, this may provide a ready-made source of recommendations.

A second issue concerns the *internal organisation* of the firm. Maister [1982] discussed the problems of balancing different levels and specialisms inside a professional firm. However, in an MSAF certain particular problems exist. Small staff numbers mean that partners are deeply involved in day-to-day activities. In our case-study we found that they devoted little time to considering longer-term strategic issues. This problem is crucial if a new strategy is to be designed and followed through. It implies that partner-time must be earmarked for this purpose, probably by appointing a strategy partner and giving him a sufficiently light client load to allow him to fulfil these duties.

*Quality of services* appeared to be a very important element in clients' and business advisers' evaluation of MSAFs, and this was borne out in the interviews. Important aspects of quality appeared to be personal relationships with MSAF partners and staff, speed of response, and a feeling that the firm is keeping the clients' interest under review. As professional services is an area in which the client is frequently unable to judge the quality of what he buys, even *after* he has received it, the factors listed (which *can* be judged) are likely to assume great importance, rather than expertise, which may not be assessable. This implies both organisational arrangements for quick response, and staff (and partner) training to provide a warm and 'caring' approach to clients.

Pricing is a growing issue in this market and is an area crying out for further research. Accountants regularly complain about inability to charge 'full fees'. This, however, assumes that their full cost plus mark-up method of pricing is equally appropriate for each client. In order to increase the acceptability of higher charges, it may be necessary to educate clients to recognise that they receive a number of different services from their accountant, and to expect a separate charge for each. In addition, as the client is probably unable to judge the quality of what he receives and may feel little benefit from audit or annual accounts preparation, it may be desirable to make visible to him the quantity and quality of the *inputs* needed to provide those services.

#### CONCLUSIONS

This article has drawn on our own case-study and surveys and other published surveys to examine the strategic problems of the MSAF. The

evidence suggests that such firms face three different forms of competition, from large firms, small firms and other firms of the same size. They can expect the competition for their largest clients to be intensified in the future, and change of accountants generally may well become much commoner than in the past.

This suggests that MSAFs need to consciously adopt a policy of pursuing 'dynamic stability', expecting continually to lose large clients and gain smaller ones. The firm can expect and plan to service clients through a part of their business lives. This somewhat simplifies the choice of range and level of services to be offered, as it is futile to attempt to compete with the largest firms on this basis. It does, however, place great emphasis on maintaining a flow of new business to replace departing clients. New clients are likely to be most accessible at times of change when business advisers of various types (especially banks and solicitors) will be involved with them and can therefore be valuable sources of new business. However, as Watkins, Wright and Chiplin [1986] suggest, advertising to raise client awareness of the firm's existence and the range and quality of its services, could be valuable in 'preparing the ground'.

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