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The Big-5 in New Millennium: The Transition to Multidisciplinary Service Provision

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As the new millennium draws near, the business world is experiencing a number of radical changes on a global scale. Globalisation, information technology, increasing competitive pressures and changing international law have set the scene for a vastly changing business environment for the 21st century. The future prosperity of the accounting profession will depend on its ability to manage this change and to be prepared to adapt to capitalise on new opportunities. In particular, the Big-5, with their immense size and resource pool, are well placed to respond to and take advantage of these changes in the global business environment. The impact of the response of the Big-5 to the anticipated market parameters of the new millennium raises a number of interesting issues in terms of the impact they have on the various segments of both the accounting profession and the entire business community.

(1) INTRODUCTION AND BACKGROUND

> The real wave of the future is not Marxism, but free enterprise. It is not centralization, but decentralization. It is not the public sector, but the private sector. And, finally, it is not the nation-state but internation.
>
> \- Arthur K. Watson

A modern corollary of Arthur Watson's oft-quoted premonition with respect to the future of the accounting profession may be that "it is not attest auditing, but multidisciplinary service provision". Indeed, this appears to be the view that major players in the accounting industry have taken in the past decade. In recent years in particular, the Big-5 audit firms have actively sought to create a "one stop shop" for all their clients' needs by seeking to restructure in three principal ways. First, the range of services offered by the Big-5 has increased significantly over the past decade.[1] Second, this period has also witnessed the contraction of the Big-8 to the Big-6[2] and, more recently to the Big-5[3] (with persistent speculation about the

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possibility of the Big-4[4]). Third, for many years, Arthur Andersen was in the unique position of being the only firm to have a global partnership. However, PricewaterhouseCoopers (PwC), KMPG Peat Marwick and Deloitte Touche Tohmatsu (DTT) have announced their intentions to mimic Arthur Andersen and put in place a globalised partnership structure. The aim of these initiatives is to adapt to increasing commercial globalisation. With a global structure, the Big-5 aim to provide a more seamless provision of service to their multinational client base, both geographically and divisionally.

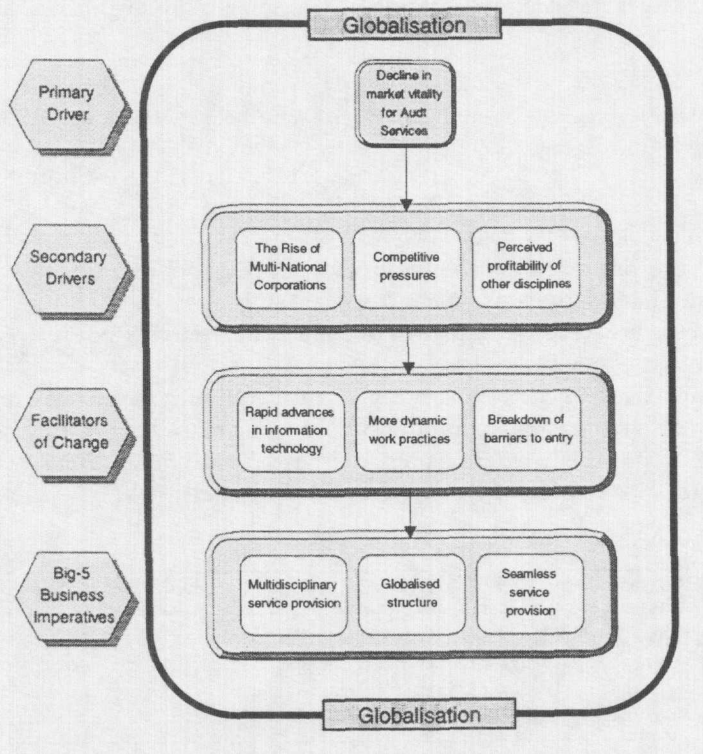
These changes in the contours of the Big-5 pose a number of questions. This paper considers the drivers and facilitators of such change, analyses the strategic position of the Big-5 as they move into the new millennium and the likely impacts of these developments on the profession and other interested parties.

(2) DRIVERS AND FACILITATORS OF DIVERSIFICATION

Figure 1 below presents a model that identifies both the drivers and facilitators of change, as well as the business imperatives of the Big-5.[5]

FIGURE 1

Drivers and Facilitators of Change



In summary, the primary driver of change has been the stagnation of audit fees, which has forced the Big-5 to seek alternative growth and profit avenues. In addition, the rise of multinational corporations, the perceived profitability and growth of other disciplines and competitive pressures have further driven this change. Even though all of these drivers are not necessarily new phenomena, a number of enabling factors, namely rapid advances in information and telecommunication technology, more dynamic work practices and the continuing erosion of regulatory, geographic and cultural barriers to entry, have provided the means for change. As seen in the model, globalisation is an overarching factor that impacts, to varying extents, on all of the drivers and facilitators of change. The recent behaviour of the Big-5 represents a deliberate strategic decision to establish what is in effect a 'one-stop shop' across the globe to provide for all a client's business needs.

2.1 The Primary Driver of Change - The Decline in the Market Vitality of Financial Report Auditing

Auditing is a critical element of the contemporary corporate marketplace. A substantial body of empirical research has documented the importance of auditors and audit quality.[6] However, in recent years, challenged by stagnant revenues, increased competition, broader sources of information, more sophisticated and reliable accounting software and greater on-line access to databases, auditors have been forced to expand their services. The evidence in relation to fee revenue highlights the slow decline in the importance of the statutory financial statement audit from the perspective of the public accounting firm. The Elliott Committee reports that over the last seven years, real accounting and auditing revenues for the top 60 firms have been flat despite growing GDP. Elliott (1995, p. 118) concludes:

> The market seems saturated; there is overcapacity and price competition; and the inherent reliability of accounting data has increased with improvements in business information systems.

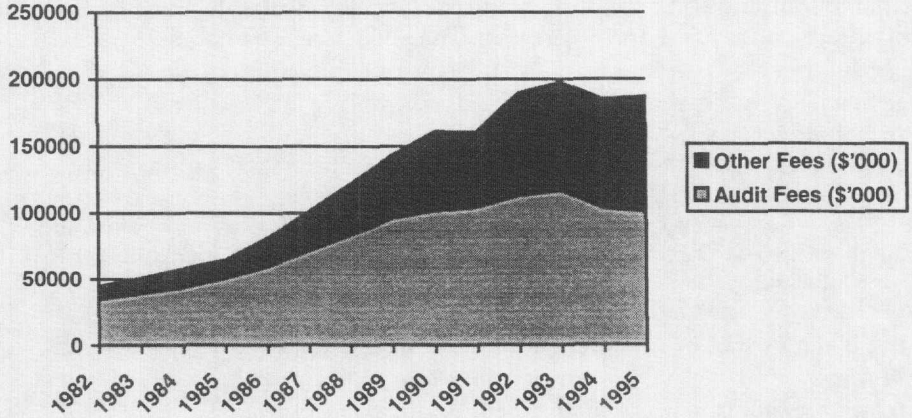
Figure 2 shows that in Australia, audit and other fees have increased steadily over the entire period of analysis, in nominal terms. It also graphically illustrates the increasing significance of non-attest fees to public accounting firms.[7]

Further, the audit fee ratio[8] reported in Figure 3 evinces a decline from 1.134 in 1982 to 0.595 in 1995, indicating a real decline in returns to auditors.[9] This decline in the audit fee ratio from 1982 to 1995 occurred at a time when auditors were experiencing increasing costs in the form of salaries and inflation.[10]

(3) THE COMPETITIVE POSITION OF THE BIG-5

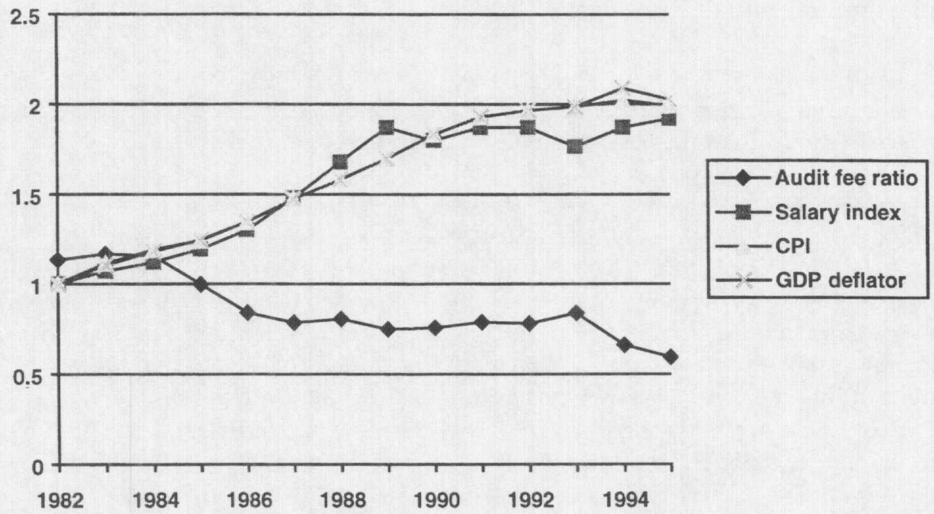
Clearly, the Big-5 firms possess a number of core competencies and strengths. They enjoy strong reputations for quality in the traditional areas of service established over decades of practice throughout the world. All of the Big-5 firms have a large pool of skilled human resources. Unlike much of the legal and consulting sectors, which tend to be localised and fragmented, the size of all of the Big-5 organisations provides substantial economies of scale and scope. Moreover, the relationship established by the audit may permit a modicum of cross-selling and referrals of services. The audit process itself is useful for identifying opportunities and the so-called practice of "low balling" by the Big-5 firms is widely alleged to be a pricing strategy vehicle for securing other more lucrative services.

FIGURE 2
Fees Paid to Auditors by the One Hundred Largest Listed Australian Companies 1982 - 1995 (nominal terms)



However, a number of factors may impede the Big-5 in their efforts to establish "one-stop shops". The "bean counter" image of accountants, regulations preventing multidisciplinary service provision (particularly in the area of legal services) and professional staff requirements represent important challenges that these firms will have to overcome. Further, the strong reputations and client relationships of many legal and consulting specialists will have to be undermined if the Big-5 are to successfully proceed.

FIGURE 3
Changes in Audit Fees and Economic Indicators[11]



(4) IMPLICATIONS AND ANALYSIS

The one-stop shop conception of multidisciplinary service provision represents a dramatic paradigmatic shift in the Big-5 chartered accounting firms. This section explores issues associated with this movement.

4.1 Breaking Into Established Markets

There are a number of opportunities that the Big-5 firms can explore in terms of expanding the services they offer to clients, as shown in Figure 4.

Firms outside the accounting profession currently provide the bulk of these services (in particular information technology, consulting, corporate finance and legal services). It would seem that advocates of the one-stop conception might be underestimating the strong relationships already developed between these firms and their clients. In the legal sector in particular, a number of large firms hold a relatively large concentration of the corporate market. Many law firms are relationship driven with their customers. Further, the Australian legal market is already extremely competitive and saturated as evidenced by the failure of the international law firms to secure significant market share.

A recent survey conducted by AC Neilsen on behalf of KPMG highlights the perception that accountants are best equipped to handle routine, less sophisticated legal work, but lack the requisite skills to provide top-quality legal advice.[12] Other salient results of the survey were:

- the high awareness of the legal services offered by the accounting firms; and
- the three principal perceived advantages of a one-stop shop were saving time, clearer accountability/responsibility and more integrated work.

This outcome is consistent with a December 1997 *Business Review Weekly* survey of a pool of 150 CEOs, in which only 21% stated that it was likely that their organisation was likely to obtain both accounting and legal advice from one firm. These factors suggest that a number of big companies want to buy their corporate advice from a number of sources and suggest that any large-scale foray into the Australian legal market would be particularly difficult. However, segments of the international market may represent a more achievable proposition, particularly in relatively new and untapped markets, such as areas of southeast Asia. As already mentioned, the Big-5's reputational capital puts them in an excellent position to take advantage of these emerging markets.

FIGURE 4
Opportunities Available to the Accounting Profession[13]

Service	Description
Services to global organisations	• Provide advice on new markets and systems. • Manage global operations around legislative boundaries.
Change management	• Assisting organisations in coping with organisational change.
New assurance and performance measurement services	• Provide assurance on non-financial performance criteria. • Deliver measures of value to the client, which could include shareholder value and return.
Strategic management	• Advise on the high level, strategic initiatives of the client.
Information technology	• Supply expertise in the introduction of new technologies to increase efficiency. • Offer data and systems assurance services. • Provide electronic transaction management and security services.
Finance	• Provide financial administration expertise. • Capital markets advice. • Provide guidance in the area of international financial regulation.
Compliance systems accreditation	• Auditing and accrediting companies' compliance systems to AS3806 (the 1998 standard which provides principles for the development, implementation and maintenance of effective compliance programs within both public and private organisations).
Knowledge management	• Provide services in relation to information authentication, management, interpretation and evaluation. • Facilitate continuous real time reporting.
Outsourcing	• Taking over certain functions of the client's non-core operations (such as the accounting function) where it is inefficient for the client to carry out these activities.
Legal Advice	• The provision of legal services in a range of areas, such as corporate law and banking and finance.

The management consulting market can be broadly decomposed into three segments: strategic consulting, operational consulting and IT consulting. It is these latter markets, that the Big-5 have expanded in the past decade. The more price insensitive strategic consulting area, which in Australia is dominated by the likes of niche consulting houses Bain and Co, Boston Group Consulting and McKinsey, represents a difficult yet not insurmountable goal.

Thus whilst the opportunities for service expansion exist for the Big-5, they will need to compete with other professions who are already established in these markets in order to obtain market share. Survey results suggest that the notion of 'one-stop shopping' seems to be regarded with less enthusiasm by customers than the Big-5 firms. To this end, some commentators suggest that the Big-5 firms and not their clients feel the value of the "one-stop shop" conception. Gallagher (1998) for example, comments:

> I continue to be surprised at the failure of the big firms to recognize that "one-stop shopping" is kind of like the "hub and spoke" thing is to the airlines: good for their business operations, but of questionable value to their customers. How good is it, really, for a Fortune 500 client – any client for that matter – to be essentially captive to any one service provider, especially in areas as broadly sensitive as accounts, taxes, corporate strategy ...

4.2 The Big-5 and Other Professional Firms

The change in focus of the Big-5 could potentially alienate medium and small 'accounting' firms from more lucrative clients. The way in which these firms respond will be interesting to follow. A number of possibilities exist. Smaller firms could potentially evolve into 'no-frills' assurance providers.[14] Alternatively, they may seek strategic alliances with similarly sized professional firms in both accounting and other professions. This alternative could prove problematic in the long term, with different cultures, work practices and strategic aims and objectives difficult to align. Another option is a series of multiple mergers in order to attain the size required to attain economies of scale and scope. However, this too would be a messy process, since it would involve the merger of several work practices and corporate cultures. In addition it would be difficult to find enough firms who would be willing to merge. Finally, second-tier firms may be absorbed by Big-5 firms that are seeking to increase size over that achievable through organic growth. For example, Sydney-based accounting firm Greenwood Challoner has recently agreed to merge with DTT.[15]

Another factor to consider in this area is that large professional firms in other industries could expand into traditional Big-5 accounting services. This has already occurred to a limited extent. Merrill Lynch, Oppenheimer and American Express in the US have acquired several accounting practices over a period of time, recognising the value of the CPA as a channel of distribution for a variety of services.[16] Whilst movements in this area have been limited, this is an impending threat that could escalate if the Big-5 make significant inroads into the markets of other professions.

4.3 Threat to Independence and Integrity

Another important dimension of multi-disciplinary service provision are issues relating to independence. Conceivably, conflicts of interest may arise between the provider of audit or consulting services on one hand and legal services on the other. It is often argued that accounting firms should not practice law because accountants owe duties to their clients that conflict with the client obligations of lawyers. This is particularly acute in the context of any negligence claims against the service provider. Further, the size of the Big-5 firms is such that there is a high possibility that the interests of one client would conflict with the interests of another. The SEC in the US has taken a strict view on combined legal and audit service provision. However, it seems that this is not a major deterrent in the eyes of the Big-5 who vigorously defend the integrity of intra-organisational "Chinese Walls".

4.4 Professional Staffing and Training

A key area in providing an expanded range of products and servicing an ever-extending geographic area is professional staffing and training. Professional experienced staff are required in a number of locations. By way of illustration, Big-5 giant PricewaterhouseCoopers purports to need to recruit an extra 1,000 professionals per week globally in order to deal with client demands. This may prove to be difficult to satiate, particularly in less developed nations. The sheer size of this demand may feed into large-scale poaching and possibly a gradual increase in the price for intellectual capital. It will also put the focus back on what is essentially every professional service firm's greatest asset: employees.[17]

Professional training will need to be revised and broadened in light of the aforementioned developments. Whilst the importance of developing skills in the fundamentals of accounting and assurance are still important, greater emphasis needs to be given to developing business acumen, giving the accountants the ability to provide a more all rounded service to their clients. Professional bodies around the world have recognised this and incorporated this objective into their visions for development in the future.[18]

4.5 Competitions Policy

Broadly put, section 50 of the Commonwealth *Trade Practices* Act 1975 empowers the Australian Competition and Consumer Commission to enforce legislation designed to prevent anti-competitive mergers and acquisitions.[19] The test applied by the ACCC in its consideration of a proposed merger is whether the relevant merger "would have the effect, or likely effect, of substantially lessening competition in a substantial market for goods or services".[20]

In late 1997, the ACCC conducted a competition analysis relating to the PwC merger along six product lines: (1) audit and accounting services; (2) taxation advice; (3) management consultancy services (MCS); (4) corporate recovery and insolvency advice; (5) corporate financial advice and (6) actuarial services. The ACCC concluded that it was unlikely that the PwC merger would substantially lessen competition in any of these areas and decided not to intervene.[21] They reported that market inquiries revealed that audit clients widely believed that they could ensure a competitive price for the Big-5 services they purchased. The ACCC also noted that vigorous competition in the market place, the bargaining power of clients and the fact that niche firms have successfully made inroads into all markets investigated (with the exception of auditing services consumed by large organisations).

It is unclear whether any further merger activity would be so charitably treated by the ACCC. Nonetheless, fragmentation and competitive intensity remain characteristics of important markets, as reflected in the data collected by the ACCC. This data is presented in Figures 5 and 6 which contain market share allocations by fee revenue within two significant markets: the UK management consulting sector and the Australian taxation profession.

FIGURE 5
Shares of Management Consultancy Fees (UK) (Pre-PwC Merger)

Firm	Share of fees
Coopers & Lybrand	8.28
Andersen Consulting	6.09
KPMG Management Consulting	5.41
IBM Management Consultancy	5.34
CAP Gemini (UK)	4.75
Gemini Consulting	4.51
Deloitte Touche Tohmatsu	4.47
Price Waterhouse	4.23
McKinsey	4.04
Ernst & Young	3.64
Other Firms	49.24

Source: Goddard (1998)

FIGURE 6
Shares of Tax Profession (Australia) (Pre-PwC Merger)

Firm	Share of fees
Coopers & Lybrand	20.64
Price Waterhouse	20.22
KPMG	17.19
Arthur Andersen	13.92
Ernst & Young	13.08
Deloitte Touche Tohmatsu	10.51
Mallesons Stephen Jacques	2.01
Other Firms	2.43

Source: Goddard (1998)

(5) CONCLUSION

Rapid advances in information technology and heightening competition in socio-economic environments of advanced industrial societies have created an entirely new information-based landscape of customer needs and expectations, innovation and prospects for the future. In addition, a trend towards deregulation has opened up previously closed markets, which has presented vastly increased market opportunities for the Big-5 in areas of accounting/assurance and other professional services.

The imminent expansion of the Big-5 firms raises significant competitive and control issues. These changes and prospects represent a watershed period for the accounting profession and call for responses from other professional firms and raise issues with respect to staffing, competition and independence. This paper has provided an overview of recent developments and canvassed some of the important issues associated with diversification. Strategic reactions and counter-reactions remain difficult to predict. Likely outcomes will be further strategic acquisitions and alliances to gain critical mass and knowledge in areas where presently the skill set of Big-5 is underdeveloped such as the information technology and legal sectors. Nevertheless, it is hard to envisage the Big-5 firms making substantial inroads into the legal profession and the strategic management consulting sector in Australia in the foreseeable future. What is certain is that large, progressive firms will continue to jockey for dominance in lucrative markets and continue to encroach on alternative domains which in turn presents important challenges for regulators. How long will be it before we see a Pricewaterhouse-CoopersAllenAllen&HemsleyBainInternationalConsulting mega firm? Or is it indeed feasible? In the words of the ancient Chinese curse, we live in interesting times.

ENDNOTES

1 In Europe, the large accounting firms dominate the legal services industry attributable in part to differences in legal systems. In Australia, Andersen Legal has grown to 75 lawyers in four years and KPMG Solicitors has recruited 40 lawyers in a relatively short period. In addition, Deloitte Touche Tohmatsu (DTT) announced plans in 1998 to merge with a major Australian law firm sometime in 1999 and to employ in excess of 2,000 lawyers globally by the new millennium. In addition, PwC has mooted the introduction of such services, with the aim of building the fifth largest law firm in the world in the next five years. On top of these movements in the legal sector, significant growth has been observed in both IT and management consulting practices of Big-5 firms. For example, in the year ending 30 September 1998, DTT recorded a 30 percent increase in its consulting revenues and a 23 percent increase in tax practice fees. In 1997, for the first time, the 100 biggest accounting firms in the United States earned more from consulting ($8.3 billion) than they did from either auditing ($7.9 billion) or tax ($5 billion).

2 The recent merger activity among the Big-5 is far from the first wave of industry consolidation. In the late 1980s, Deloitte Haskins & Sells coupled with Touche Ross and Co to create Deloitte & Touche, and Ernst & Whinney joined with Arthur Young & Co to form Ernst & Young, reducing the then Big 8 to the Big 6.

3 On 18 September 1997, Coopers & Lybrand and Price Waterhouse announced in the US they intended to merge. The merged entity was constituted by 8,500 partners and a staff of 130,000 globally and was expected to generate revenues $US13.5 bn. In Australia, Coopers & Lybrand was reportedly the largest of the Big-6 and Price Waterhouse the third largest at the time of the merger announcement, with the combined entity having revenues of around $800m, 550 partners and 7,500 staff locally.

4 To this end, on 20 October 1997, KPMG and Ernst & Young (E & Y) announced that they also intended to merge. This merger was expected to involve revenues in excess of $US18bn, 12,800 partners and 163,000 staff internationally. However, on 14 February 1998, KPMG and E & Y called off their proposed merger.

5 It should be noted that the drivers and facilitators contained in this model are not independent of each other. In fact, it is considered that many of these factors are interrelated.

6 An influential body of literature relating to auditor switching and the economics of auditing underscores the practical significance of auditors. Findings from empirical research in this area indicates that the selection of auditors can be used strategically as a signalling device:

- Companies wishing to signal increased growth prospects will switch to a larger, higher quality auditor: see Feltham, Hughes and Simunic (1991); Menon and Williams (1991).
- Firms increasing (decreasing) company debt will seek to select a replacement auditor of a higher (lower) quality: see DeFond (1992). Audit firm size is generally used as a proxy for quality.
- Companies switching auditors prior to a new securities issue will change from a local CPA firm to a larger auditor: see Simunic and Stein (1995).
- Selection of a similar or a higher quality auditor would be an indication of management utilising the most efficient set of accounting policy choices: see Craswell, Taylor and Woolcott (1996).
- Risky clients are more likely to seek and switch to a larger, Big Five auditor with 'deep pockets': see Palmrose (1986); Clarkson and Simunic (1994).

In short, studies examining the characteristics of firms switching auditors have found that switches to Big Five firms were associated with size, leverage and growth increases.

7 Adapted from Craswell (1996).

8 This ratio measures the average of the ratio of audit fees to company assets where assets are measured in thousands of dollars.

9 As Craswell (1996) points out, changes in the professional regulation in the early 1980s led to an increase in price competition among auditors. With the relaxation of professional rules that inhibited competition among members of the professional bodies, audit fees adjusted downward consistent with the changing market conditions. The real decline in returns to auditors has also been attributed, in part, to changes in audit methodology during the decade of the eighties. For example, Craswell points out that auditors embraced a more risk-based approach and there was an increase in the use of computers to analyse client data. This enabled auditors to reduce costs by substituting capital for labour and by using labour more efficiently.

10 The main costs of auditing are labour, office accommodation, litigation and technology.

11 The Salary Index is calculated using median starting salaries for accounting graduates published by the Careers and Appointments Service of the University of Sydney. The CPI (all groups weighted average for eight capital cities, base 1982 = 1.000) and the GDP deflator (implicit price deflator, gross domestic product, base 1982 = 1.000) have been extracted from the Australian Bureau of Statistics.

12 Approximately 300 of the top 1000 companies in Australia and New Zealand in terms of market capitalisation responded to 11 questions. Only one-third of the survey respondents said that they would prefer a "one-stop shop" for professional services. Of the remainder, Neilsen observed:

> Legal advice obtained from companies with both accounting and legal services was not perceived to be specialist, or at least not competitive with advice from dedicated legal firms. Two of the main reasons cited for not preferring a one-stop shop were (i) the perception that generalists can't be specialists and (ii) that respondents find the individual with the best specialist knowledge rather than a particular firm.

13 These opportunities have been adapted from the opportunities identified for Chartered Accountants in the Vision 2020 report written by the Institute of Chartered Accountants in Australia.

14 In other words, the lower tier firms could become lower priced audit specialists for firms that do not want to pay the Big-5 premium fees to secure access to services that they might perceive to be unnecessary.

15 See Fenton-Hughes (1999).

16 American Express has established a Tax and Business Services Division (TBS). Through this, they have acquired Alschuler, Melvoin and Glasser, who were the largest accounting firm in Chicago after the Big-5. Other accounting firms acquired by TBS included Checkers, Simon & Rosner (Chicago's 13th largest firm). See Melancon (1998).

17 The Big-5 will have to work to find ways of engendering loyalty and long term commitment, something which little attention has been paid to in the past, as evidenced by the high attrition rates post PY in Big-5 firms.

18 Recognition of the need for education reform has been recognised in the Vision 2020 report by the ICAA, The Elliott Committee of the AICPA and the Chartered Accountants in 2005 report produced by the ICAEW. In terms of positive action, moves are afoot to revise the training provided to potential CA's in Australia. A new CA Program will eventually replace the Professional Year. However, the exact nature of this new training programme is unknown. Therefore, whether the rhetoric of professional bodies is to be reflected in a more relevant and robust course remains to be seen.

19 Such transactions may be authorised under section 90 of the *Trade Practices Act* in cases where there are sufficient offsetting public benefits associated with the merger or acquisition.

20 Sections 50 and 50A of the *Trade Practices Act* 1975 prohibit mergers or acquisitions which fail to meet this test.

21 For an in-depth discussion of the ACCC analysis of the merger written by the Director of the Mergers and Asset Sales Branch of the ACCC, see Goddard (1998).

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