

INTERNATIONAL ACCOUNTING FIRMS: THE BIG FOUR EVOLUTION

By

Norman E. Cruz
Faculty
Puerto Rico Campus
University of Phoenix

Abstract

Author reviews academic literature and discusses about multinational enterprises (MNEs) in the service sector that decided to improve their businesses by forming strategic alliances. It is covered specifically the alliances of international accounting firms (IAFs) to establish the following objectives: review major reasons for companies to create strategic alliances and their preferred modalities, and verify the IAFs business performance based on their revenues obtained on 2004 and 2014—before and after the most recent worldwide economic recession.

Keywords: International Accounting Firms, Strategic Alliances, Economic Cycles, SOX

Introduction

Morse (1992) defines strategic alliances as arrangements between companies that assist in the penetration of a new market by one of the companies. Examples of alliances are: the licensing of one company by another to manufacture and sell its product or provide its service; the sub-contracting of one company by another to produce its product or provide its service; the marketing of one company's products or services by another company or by both companies jointly; the distribution of one company's products by another company's distribution network; the representation by an agent for the sales or services of a company; the transfer of technological information from one company to another; and the importation into a country of a company's product by an importing company located therein.

In recent decades, many companies decide to re-structure their organizations by performing alliances, among other options in order to increase their power or attractiveness no matter from which industries are and to which markets serve (Bushko & Raynor 2000, Segil 2000, Stahl 1995, Roberts & Liu 2001). These corporate re-organization strategies had their peaks in United States by 1980s and in the rest of the world by 1990s, when economy showed growth.

Due to their nature, certain industries need to respond more quickly than other ones to establish new strategies and take advantage of their competitors. For instance, the IAFs are in an industry where services offered are in constant demand and are interested by competitors with huge resources—e.g., capital, people, and technology. This situation justifies why sometimes companies decide to modify their organizations by creating alliances in a speedy fashion.

Most frameworks used to aid managerial decision-making in multinationals are largely based upon data collected in the manufacturing sector. Much of the recent restructuring occurring in manufacturing MNEs such as downsizing, renewed focus on core business and a growing dissatisfaction with conglomerate operations are consistent with the normative prescriptions of these frameworks. However, in contrast to these trends, the service sector has been characterized by a different pattern of organizational restructuring. This pattern includes continuing internationalization and increasing company size and scope. This suggests that there may also be critical differences in the principles, which guide the strategic management of service companies (Campbell & Verbeke 1997).

Strategic Alliances

This manifestation of organizational cooperative strategies has been focus of numerous studies in the business literature mainly in the manufacturing sector. Strategic Alliances

comprise companies that remain legally independent and cooperate to achieve a competitive advantage by exchanging or consolidating resources and services (Kogut 1988). Alliances preserve legal independence and even economic autonomy - outside the field of cooperation. The linkage of participating companies may terminate unilaterally (reversible).

Strategic alliances whether with competitors, suppliers, vendors, or complementary partners are frequently the most efficient and effective means for achieving immediate access to the capital, talent, distribution channels, or manufacturing capabilities essential for maintaining market leadership (Garai 1999). Alliances are more favorable in the face of high environmental uncertainty and knowledge dispersion because collaborations increase strategic flexibility and rapid learning (Hoffmann & Schaper-Rinkel 2001).

The objectives underlying the entry into strategic alliances are due to several motives (Varadarajan 1999), such as: market entry and market position, product or service, product or service market, market structure modification, market entry timing, resource utilization efficiency, resource extension and risk reduction, and skill enhancement.

After their respective studies, Freidheim Jr. (1999) and Segil (2000) consider that ingredients for successful alliances are:

- Know what your company wants in an alliance partner and why—have a clear vision and understanding why an alliance is important to achieving it;
- Pick your partner for positive reasons—set your selection criteria and do not choose a partner because it is the best available;
- Ally for the long term—go in with the intent that the alliance will last as long as the business opportunity;

- Make the benefits and risks equitable—an unhappy partner will get even or get out, thus structure the division of value created so that company will be willing to accept either partner's position;
- Assign the best and the brightest—assign people to win—unwillingness to put top talent into an alliance is a sure signal of the value of the alliance;
- Ensure the alliance has common objectives—understand why your partner wants the alliance and whether its objectives are consistent with your company's objectives;
- Communicate—invest in the infrastructure that makes it easy to communicate and do business together;
- Hope for the best and prepare for the worst—take breakup provisions and make it tough to trigger dissolution;
- Invest—continued support, investment and attention often separate successful alliances from unsuccessful ones;
- Master the details—alliance leaders do business better than anyone else does; and
- Cultural compatibility—for companies collaborating with foreign businesses, it is critical that they eliminate barriers, such as language differences.

Evolution of International Accounting Firms

Back in the early 1970s, the accounting profession was a gentlemanly affair. Auditors were like bankers: conservative, straightforward, and ethical to a fault. Indeed, accountants routinely topped the lists of most-admired professionals. The shift can be traced to 1978, when the American Institute of Certified Public Accountants (AICPA) revoked the veto on advertising and solicitation. The end of that prohibition triggered a land grab in the accounting industry, and a big push into consulting services (Goff 2004). The pressure that high competition is providing

to the consulting companies make that IAFs be protective with their personnel. According to Ernst & Young, up-to 25% of its former employees comes back to the company, keeping their knowledge and experience out of their competitors.

The IAFs, specifically the Big Four—Deloitte Touche Tohmatsu, Ernst & Young, KPMG, and PricewaterhouseCoopers—are currently established as limited liability partnerships. Originally, they were oriented to the following main core of services: tax and audit. Throughout the years, these companies started to work in many countries as possible—e.g., within Europe, North America, Latin America, Africa, and Asia. This involvement grew out of their desire to follow important clients overseas.

As indicated on their annual reports, the IAFs open new offices around the globe by placing human resources—e.g., partners, principals, managers, seniors, staff, and administrative personnel—from current offices, or by forming alliances with local service companies. Thus, it has been necessary to provide new and innovative services, such as: financial advisory services, and consulting in as many industries as possible. Their clients are in the following business sectors: automotive; energy, utilities and mining; industrial products; pharmaceuticals; retail and consumer; services; banking & capital markets and investment management; insurance; entertainment and media; communication and technology, among many others.

In seeking to serve these clients, a variety of arrangements were developed across and within enterprises. Seven major types of arrangement have been utilized, usually varying according to the relationship between the international company and the local practices (Daniels, Thrift, & Leyshon 1989). These arrangements are identified as: the company operates under its own international name—e.g., PricewaterhouseCoopers; a combined name is used where an international company affiliates with a local company; a local name is used where the local

company is totally affiliated with the international company; an association or federation may be relied on to coordinate activity among member companies; correspondents may be used if an international company does not have an office in a particular area and exclusively refers clients to a single local company; on rare occasions, a local company may have multiple affiliations with several international companies; and a final case is when two or more names occur, where an international company practices under two or more national company names.

The first alternative is although there are still cases where the affiliate will use an alternate name or a hyphenated one. However, the general trend has been a move to a single name and a single identity (Brown *et al*, 1996). This is the case of Transaction Advisory Services Co. (TASCO), a joint venture arrangement between Ernst & Young LLP and Shell International Limited (Everest Partners, 1999).

Ernst & Young LLP

In early 1997, Shell was looking for a way to change the manner it ran its back office. The company wanted to create a much more proactive financial accounting department. Thus, part of its strategy was to consolidate the accounting functions of its European subsidiaries through a shared service center. After undertaking a feasibility study, Shell made the decision that shared services was the right solution to address its needs. However, Shell perceived that it would not be successful in implementing shared services by themselves for several reasons; it wanted to move quickly, cover a range of financial accounting services, and cover an extensive geographic scope, according to TASCO CEO Jacky Ross.

At the same time, Ernst & Young was looking for a partner because it wanted to enter the accounting outsourcing market. Ernst & Young is one of the world's leading accounting, tax, and consulting enterprises, but it has always worked from an advisory and audit perspective. It

has never ever done the accounting work. TASCOS already achieved its mission, which was to become a market leader in accounting in Europe.

For Gary Shamis, managing partner at Leading Edge accounting company SS&G Financial Services in Cleveland; during the 1980s, a lot of accounting organizations were merging to remain a viable alternative to the IAFs. Most companies, in order to compete on a local basis, needed some national and international resources and exposure. They joined because of the locations of where they conducted business.

KPMG LLP

As stated by KPMG (2014a), transforming an enterprise is often critical for growth and long-term success. That is why leading organizations turn to the KPMG and IBM Alliance to help transform their businesses and achieve better results.

KPMG's strategic alliance with IBM combines the business performance, financial, regulatory, risk management, and tax competencies of KPMG with the technology expertise of IBM. The alliance leverages their combined strengths and proven ability to collaborate to help resolve their clients' business issues and provide compelling and unique solutions in each engagement.

KPMG and IBM have collaborated on hundreds of engagements for world-leading companies to help solve their Finance, Business and Human Resource Transformation, Enterprise Resource Planning—Governance Risk and Compliance, Security and Data Privacy issues. Together, they have helped transform their enterprises while helping them manage risk and optimize results.

Deloitte Touché Tohmatsu LLP

On June 10, 2014, Deloitte and Panaya announced a strategic alliance to give Oracle E-Business Suite customers the power to create more business impact by reducing the cost and risk of application change projects, without compromising on stability or quality.

Many Oracle E-Business Suite implementations involve custom code and dependencies with other enterprise applications, making it time and labor intensive to find and fix issues triggered by upgrades, patches, customizations, rollouts and application changes. Deloitte will use the Panaya Quality Management Cloud to help its clients accelerate their testing activities, deployments, and overall project delivery (Deloitte Touché Tohmatsu, 2014a).

PricewaterhouseCoopers LLP (PwC)

Very recently, on October 28, 2014, was announced the launch of a joint business relationship to bring new and innovative services to companies around the world. The rapid pace of innovation in technology has fundamentally changed how and where work gets done, driving organizations to transform their businesses for the future. Together, PwC and Google will help clients by collaborating on existing solutions and developing new offerings in three areas (PricewaterhouseCoopers, 2014a):

- Help companies succeed by leveraging PwC's business insights along with Google Apps, Google's suite of cloud-enabled collaboration and productivity tools. In doing so, they will empower companies to be more productive, serve customers more efficiently and deliver a more connected employee experience.
- Use the combined power of PwC's analytical acumen and Google Cloud Platform to help businesses make the most of technology and information and be better equipped

to compete, creating new services to reinvent and optimize operations, connect with consumers and provide an enhanced customer experience.

- With the right tools and insight now driving decisions, PwC and Google will guide companies seeking to break new ground in their businesses—not only to compete with new entrants and adapt to disruptive market forces—but also to lead the innovation themselves.

These approaches may provide a fast competitive advantage to IAFs, but may bring many threats to them, such as: country regulations, legal problems, cultural issues, and appropriate allocation of resources, among others. The consequent conflicts of interest culminated in a string of infamous accounting scandals—e.g., Enron, WorldCom, and Tyco International—and the dismantling of Arthur Andersen. Many observers believed the downfall of Andersen, the passage of the Sarbanes-Oxley Act of 2002 (known as SOX— law approved by US Congress), and the establishment of the Public Company Accounting Oversight Board (PCAOB) would control the excesses of the 1990s.

The SOX mainly tries to avoid, as much as possible, that IAFs perform audit and non-audit services to the same clients. In cases that IAFs perform internal and external audits to any clients, they should ensure that these audit teams are composed of different team members. Perhaps, that explains why IAFs are interested in perform alliances with local and foreign law firms, in order to ensure that their offices around the world cannot infringe the applicable laws and regulations. Even more, many of the IAFs' actual partners are both CPAs and lawyers.

Results

Harrigan (1988) argues that cooperative agreements are transitional strategies, and that the period in which they are most appropriate is short. Companies then often engage in short-

lived cooperative agreements to keep up with the quickly changing environment by means of relatively small investments. As an industry matures, the rate of changes slows down and uncertainty diminishes, leading to a decline in the relative importance of the strategic alliances.

From the above strategic alliances, the lessons learned are that using shared services can help with consolidating a company's accounting functions and create a much more proactive financial department; a joint venture can allow to focus on supporting its business; a joint venture allows the newly formed company or organization the ability to draw on the resources of two companies; and a joint venture not only provides services to the mother companies, but can also make a profit by winning the business of third-party customers.

Besides all risks that may face the IAFs, so far these companies have good portion of the global market. Refer to Table 1, where the revenues and staff of the IAFs are compared between them.

Table 1. Relation of IAFs regarding revenues and total staff

International Accounting Firm	Year	Revenues (USD millions)	Total Staff
PricewaterhouseCoopers (2004 & 2014b)	2004	17,600	122,471
	2014	33,952	195,433
Deloitte Touché Tohmatsu (2004 & 2014b)	2004	16,421	117,000
	2014	34,200	210,400
Ernst & Young (2004 & 2014)	2004	14,547	100,601
	2014	27,400	190,000
KPMG (2004 & 2014b)	2004	13,440	93,983
	2014	23,400	155,180

The IAFs have increased their staff during 2004 and 2014, as shown on Table 2.

Table 2. Relation of IAFs with respect to the 2004 and 2014 staff

International Accounting Firm	2004 Staff	2014 Staff	Annual Increase
PricewaterhouseCoopers (2004 & 2014b)	122,471	195,433	5.96%
Deloitte Touché Tohmatsu (2004 & 2014b)	117,000	210,400	7.98%
Ernst & Young (2004 & 2014)	100,601	190,000	8.89%
KPMG (2004 & 2014b)	93,983	155,180	6.51%

The IAFs have increased their total revenues during 2004 and 2014, as shown on Table 3.

Table 3. Relation of IAFs with respect to the 2004 and 2014 revenues

International Accounting Firm	2004 Revenues (USD millions)	2014 Revenues (USD millions)	Annual Increase
PricewaterhouseCoopers (2004 & 2014b)	17,600	33,952	9.29%
Deloitte Touché Tohmatsu (2004 & 2014b)	16,421	34,200	10.83%
Ernst & Young (2004 & 2014)	14,547	27,400	8.84%
KPMG (2004 & 2014b)	13,440	23,400	7.41%

By reviewing Table 2 and Table 3, it is demonstrated that the IAFs have been adapting well to the changes on actual economic conditions since they are having greater annual increases in revenues than in personnel, helping to growth their revenues during the past decade.

On the other hand, an interesting fact is that on 2004 these companies had average revenue per individual very similar, revealing how competitive were the IAF by that period.

While in 2014, the gap was wider between them, but keeping positive outcomes—see Table 4.

Table 4. Average revenue per individual from each IAF during 2004 and 2014

International Accounting Firm	Year	Revenues (USD millions)	Total Staff	Average Revenue per Individual
PricewaterhouseCoopers (2004 & 2014b)	2004	17,600	122,471	\$143,707.49
	2014	33,952	195,433	\$173,727.06
Deloitte Touché Tohmatsu (2004 & 2014b)	2004	16,421	117,000	\$140,350.43
	2014	34,200	210,400	\$162,547.53
Ernst & Young (2004 & 2014)	2004	14,547	100,601	\$144,600.95
	2014	27,400	190,000	\$144,210.53
KPMG (2004 & 2014b)	2004	13,440	93,983	\$143,004.59
	2014	23,400	155,180	\$150,792.63

Conclusion

The strategic alliances may lead that companies lose control over those activities that become collectivized, but they will retain control of their individual businesses. Companies will not be giving up complete control; they keep functions critical to maintaining a competitive advantage. In partnering, companies need to develop some kind of trust and builds over time.

Organizational change may be seen as a layering of a new form of organization upon the previous one (Daniels, Thrift, & Leyshon 1989). The result is competitive commitments within the company that will affect the final form of the change as individuals retain a loyalty to the national company, rather than the newly formed international entity. On this research, the IAFs have been demonstrating that their strategic alliances are working out, but need to keep in constant evolution to comply with business objectives especially during adverse economic periods.

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