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Capture of competitive advantages by Russian and international audit companies; the case of Russian market

Master’s Thesis by the 2nd year student

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ЗАЯВЛЕНИЕ О САМОСТОЯТЕЛЬНОМ ХАРАКТЕРЕ ВЫПОЛНЕНИЯ

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**АННОТАЦИЯ**

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| Научный руководитель | Верховская Ольга Рафаиловна, доцент |
| Описание цели, задач и основных результатов | Данная магистерская диссертация посвящена источникам конкурентных преимуществ, используемым аудиторскими компаниями на российском рынке. Целью исследования является выявление наиболее важных источников конкурентных преимуществ, которые влияют на эффективность аудиторских компаний. Данная работа концентрируется на малых аудиторских компаниях, поскольку именно эта часть рынка является наименее изученной. Метод исследования – кейс стади. Эмпирическое исследование основано на интервью с представителями малых аудиторских фирм в России и на данных интервью из вторичных источников со специалистами отрасли. В ходе исследования были определены три основных аспекта, влияющих на конкурентоспособность компании: участие в российских аудиторских сетях, маркетинговая деятельность и предоставление неаудиторских услуг. Установлено, что эти источники конкурентного преимущества приводят к улучшению профессиональной репутации аудитора, которая считается одним из самых важных факторов на рынке. На основании полученных результатов была разработана теоретическая модель. Данная работа посвящена развитию теории конкурентных преимуществ малых аудиторских фирм, рассматривая источники, которые влияют на эффективность компании. Практическая полезность результатов заключается в том, что данная магистерская диссертация предоставляет рекомендации для владельцев аудиторских компаний о том, как повысить конкурентоспособность, сделав акцент на определенных факторах. |
| Ключевые слова | Источник конкурентного преимущества; поставщик профессиональных услуг; рынок аудита; ресурсный подход |

**ABSTRACT**

|  |  |
| --- | --- |
| Master Student's Name | Andrei Guletckii |
| Master Thesis Title | Capture of competitive advantages by Russian and international audit companies; the case of Russian market |
| Faculty | Graduate School of Management |
| Main field of study | Management |
| Year | 2017 |
| Academic Advisor's Name | Olga R. Verkhovskaya, Associate Professor |
| Description of the goal, tasks and main results | This master thesis is devoted to the sources of competitive advantages that are used by audit companies on Russian market. The aim of the study is to identify the most important sources of competitive advantages that affect performance of audit companies. The research concentrates on small size audit companies as this part of market is less studied. The research method is multiple case study. The empirical research is based on interviews with representatives of a small audit companies in Russia and on interviews with industry experts from secondary sources. During research, three main aspects are identified to be important to company’s competitiveness: participation in Russian audit networks, marketing activity and provision of non-audit services. It is identified that these sources of competitive advantage lead to improvement of auditor’s reputation which is perceived as one of the most important factor on the market. Based on these results, theoretical framework is elaborated. This paper contributes to development of theory of competitive advantage of small audit firms, expanding the sources that affect company’s performance. Practical implications provide guidelines to owners of audit companies of how to enhance competitiveness by putting emphasis on specific factors. |
| Keywords | Source of competitive advantage; professional service provider; audit market; resource based view |

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# **Introduction**

Audit is important instrument of financial control as it investigates accounting records, financial reports of companies and provides conclusion of whether information is reliable and fair. Nowadays audit is an obligatory requirement for many companies that fall under formal indicators.

The question of competition on Russian audit market is important because of dominance of Big Four companies (Deloitte, Ernst & Young, KPMG and PwC), which occupy large market share, and overall recession of the market, which leads to decline of income from audit activity. In these conditions, SMEs need to develop a proper competitive strategy in order to be attractive for clients.

Previous studies concentrate more on Big Four’s analysis of competitive advantages – Rose (2005) studies the effect of multinational clients on big audit companies, relation of audit fees and IFRS implementation (Higgins et al., 2015), industry specialization by these companies (Casterella et al., 2004). Other researchers explore scenarios of what will happen if one of Big Four companies quits the market (Gerakos & Syverson, 2015; Velte & Stiglbauer, 2012). There are studies on competence model of an audit company and relation of audit fees and client’s influence which observe all companies. However, distinguishing Big Four and several other market leaders from other companies is essential due to obvious different competitive advantages they possess – Big Four are leaders in terms of human capital, network, reputation, supporting IT systems and so on. The comparison of all companies is neither correct as Big Four owns more almost half of the market which means that results should be adjusted to this disproportion. Sharma and Hosie (2015) and Maijoor and Witteloostuijn (1996) compare attractiveness of companies in terms of auditor’s size. During the study, researchers come to conclusion that it is necessary to analyze the market by dividing it into two groups: Big Five that existed that time and medium and small size auditors because otherwise the result is not consistent.

So researches concentrate on rather general issues or on competitive advantages comparing companies with relatively different size. While a lot is written about Big Four companies and there are researches about mid-size audit firms, it is necessary to analyze the market of small audit companies and define competitive advantages that can be used by them in order to compete against each other (there is no reason to contrast small companies to market leaders and mid-size firms as competences that they possess are different and comparison doesn’t provide any applicable result). Small companies represent market share of less than 1% each, so companies have to carefully implement their strategy in order to achieve competitive advantage. This task is more difficult nowadays because audit market is in recession.

The goal of the study is to identify sources of competitive advantage by using which small size audit company can improve its performance on highly concentrated Russian market. The objectives are to conduct literature review of audit company’s competitive advantages; to state main features of Russian audit market; to determine specifics of audit company’s operation on Russian market; to identify the most relevant sources of competitive advantage; to prove their importance based on the case of audit companies; to propose a framework that can be used by a small audit company to achieve competitive edge.

The initial stage of the research is to conduct literature review in order to define possible sources of competitive advantage, and then the research gap that exists in literature is discussed and used to build research propositions. During literature review it is identified that the market of small companies is studied insufficiently, so the paper emphasizes competition of small audit companies. Case study method is taken to address research problem because it can perfectly explain influence of Russian audit environment on research results and illustrate complexities that appear on the market. The research utilizes qualitative data to comprehensively explain the topic and the data is gathered from the semi-structured interviews with representatives of audit companies in several cities of Russia. The data gathered from the interview is processed and interviews from open sources are added to prove the results. The final step is to generalize findings in order to build a framework of small size firm’s competitive advantages on audit market and discuss how the proposed framework can be applied in practise.

# **Chapter I. Theoretical background of competitive advantages**

## 1.1 Resource Based View of a firm

In order to start analysis of what competitive advantages audit firm possess, it is necessary to identify the theory on which competitive advantage is based. In this case, Resource Based View developed by Barney (1991) is used. He assumes that resources of firms in an industry are heterogeneous and that they are not perfectly mobile which means that this heterogeneity can be sustain in time. The key concept is resources that a company possess. Resources are assets that are owned by the company and they are immobile which means that they cannot be moved from one firm to another. Because of this, resources cannot be replicated by competing firm and, consequently, the strategy is different. Success can be achieved by developing, acquiring and introduction of resources that are unique by their own or by a combination of them. Separated resources can’t be the source of competitive advantage but they can be used together in order to achieve and form organizational capability. The capability is the most important part of better performance. Teece et al. (1997) argue that it is hard to imitate resources and it is costly to transfer them from one company to another. This is due to fact that many resources consist of tacit knowledge. Hollensen (2011) states that resources are the basis of analysis but by their own, they cannot produce anything. He agrees that resources are the necessary condition of participation on the market and they are usually similar among competing firms – “resources are failure preventers, but not success producers.”

Barney (1991) also mentions that resources must be valuable – support company’s strategy. Resources also must be rare because the future rents depend on the resource’s price that, in turn, depends on its rarity. In competitive market, the resource should be owned by one company in order to get competitive advantage as competitors cannot copy them. Also rivals may substitute this resource that lowers rents and decreases competitive advantage, so the resource must be non-substitutable. The most important part of the theory is sustainability – if there are no strategic equivalents of resources.

Resources cannot be productive by themselves. However, a number of resources can be transferred into organizational capability. According to Helfat and Lieberman (2002), capability is “a firm’s capacity to deploy resources for a desired end result.” Hollensen (2011) mentions that capabilities are components of a higher level than resources are and that they are composed of resources. Formation of capabilities depends on two factors. The first factor is the ability of a company to merge resources – it is developed through learning process. The other factor is assortment of resources that creates opportunities for qualitative development of capabilities.

Dynamic capability. This model was introduced be Teece et al. (1997). They argue that there are firms that are good at adapting to new challenges. And researchers call the ability to build and change capabilities in order to address changing market dynamic capability. There are several groups of factors that affect dynamic capabilities according to Teece et al. (1997) – processes, position and path. Processes make it possible to develop capabilities. However, the processes themselves depend on path a company choose because processes can be changed to fit current strategy. In turn, strategy may be affected by the position of the company – existing assets. If it is hard or impossible to imitate a competence, than it is distinctive capability. Distinctive capabilities are built in organizations and cannot be bought from outside.

The rent is earned not on establishing a competitive advantage but on sustaining it in time. Sustainability depends on extent to which competitors can imitate competitive advantage and whether those are durable. In order to sustain competitive advantage, it must meet three criteria: transferability, durability and replicability.

Porter’s (1980) impact on identification of types of competitive advantage cannot be overestimated. He defines two generic strategies that companies can use in order to achieve competitive advantage. Those are cost leadership and differentiation strategy. Low cost strategy can be used for companies that are able to produce goods of the same quality as competitors but at cheaper price. Differentiation is a strategy aimed at providing additional value for clients in terms of quality, uniqueness of features or after-sales service. Porter (1985) calls these strategies generic because companies of any size can use them.

## 1.2 Characteristics of professional service providers

There is a group of companies that are concentrated on providing professional services to other companies that are related to business area. The services are from different spheres; according to BusinessUSA web portal exist several types of service companies:

* Accounting, audit and tax
* Business administration
* Consulting
* Business development
* Training, HR
* Investment
* Legal services
* Marketing
* Certification and standards
* Information technology

As far as audit service is a part of professional services, understanding of those is useful for research because it determines those resources that are used as a part of competitive advantages by service provides, so audit companies may use them as well. Broderick (2010) suggests that a service provider has the following characteristics:

* Respecting and investing in employees - because of nature of services, employees work with clients and it is necessary to provide appropriate education and mentoring for them.
* Work in flexible teams. Most of professional services are implemented in projects, so employees should be able to work in teams and be prepared to subordinate to several project leaders. That is the reason why flexibility and adaptation are so important.
* Companies are tied to their core competences. It is true that service companies are trying to diversify their portfolio and to increase their fields of expertise but unlike production companies that are often entering to service areas, professional service providers tend to be close to their core competences.
* Slow pace of change. Even though technological change makes operation more efficient, mergers radically change competition and regulation may shake the business and force it to adapt faster but generally business models don’t change a lot.
* Short-term orientation. While manufacturing companies have product lifecycle and standardized indices that may be projected on future periods, service area is more project-oriented which makes it unpredictable in long-term.
* Marketing and sales inefficiency. This problem occurs in many service companies as they don’t have enough expertise of how to run marketing campaigns and how to target company’s audience. Even if advertising is successful, sales team not always can improve number of clients involved. Other explanations are that there is a lack of communication between those departments and sometimes senior managers don’t understand the importance of marketing procedures to the total value created in the company. Moorhouse (2013) suggests that it is better to train your non-sales staff because they understand the service better and can professionally assist on negotiations while sales persons (who are responsible for sales in manufacturing companies) cannot be efficient when broad knowledge of topic is required.
* Pricing strategy. Moorhouse (2013) adds that pricing may be tricky question in professional service industries because it may be negotiated and depends on many factors. Each new project provides a possibility to revise current prices.
* Service customization. Professional service providers have an opportunity to customize their products in order to fit client’s needs better.

Companies are trying to achieve competitive advantage through many aspects. Ones are differentiating themselves by establishing emotional connections with clients. In order to reach this target, Brodie et al. (2013) suggest concentrating on customer engagement. The value is generated by creation of consumer experience and involvement. In this case companies should answer the question: what is the basis for consumer engagement? O’Brien (2015) states that one of the best options is to use corporate social responsibility (CSR) along with core values engagement. In this sense, engagement means the measure to which a client is ready to give physical or financial resources to CSR issue. The researcher finds out that there is almost no difference between local and global initiatives but CSR actions related to core competences (such as free call crisis service line, free of infringement content, online safety and equal access to digital technologies) are the most important for clients.

Relational aspect of clients in service industries should be considered because clients are usually co-producers of a service and are “active participants in relational exchange” (Vargo & Lusch, 2004). Schertzer et al. (2013) state that services are usually continuous and long-term oriented. However, the extent to which co-creation exists in a company is more important than time of relations. Complex services value cannot rely only on technical characteristics but excellence of relations is required as well. Relations are strong with continuation of doing business between a service company and a customer. If these relations are positive, parties must work on shared understanding and increase involvement and commitment of each other. Consequently, the quality of the service itself will be increased. Schertzer et al. (2013) mention that even if a customer is not satisfied with a service provided, durability of the relations can play a great role in improving them. Service provider should investigate the result of every service in order not only to increase quality of future service but also to lead customer relations in a tactical way, without misunderstandings and uncertainty.

Another way to get competitive advantage is to obtain a good reputation. It is proved by Milan et al. (2015) that reputationincreases switching costs for clients and improves future consumer behavior towards a company. Also, a company should establish good reputation as a part of company’s competitive strategy. Whenever a reputation is set, clients tend to order the service several times and if they are satisfied, it will lead to customer loyalty. Juntunen et al. (2014) expand the idea and prove that loyalty is very important aspect of service company’s operation as it allows to increase brand equity. Brand reputation can assists in dealing with uncertainty that usually occurs because of service’s intangible nature. Historical activity of a company is also a considerable part of reputation because new clients may choose the service provider based on name of previous customers, success of previous services provided to other clients. However, it is argued by Gomes et al. (2016) that clients consider service provider reputation only after such factors as price, service features and technology.

Previous experience is essential for clients because they evaluate companies based on it. Relatively to professional services, experience is significant relation to expected service quality and satisfaction of a service performed. Sharma and Hosie (2015) state that “the awareness of the scope of service level – both desired service level and adequate (minimal expected) service level – is generally a result of the accumulation of experience gained from interaction with the specific professional service firm.” Despite this, only 39% of firms (Switala, 2013) use experience marketing in practice – experience from previous communications. Sometimes a customer may wish to participate in service provision because he or she perceived this involvement as a way to achieve higher quality of service though it is possible to communicate only on operational level due to lack of knowledge or experience in a service area. Bone et al. (2015) suggest that involvement of client may be counterproductive and only relevant to increase minimal expected service quality.

According to Kotler and Connor (1977), some professional service providers use only few marketing activities because they rely heavily on quality. This approach is debatable as companies cannot base their strategy only on quality because in terms of RBV approach, quality is not sustainable as it can be copied by competitors. Consequently, there is a number of marketing strategies that professional service providers can use in order to achieve competitive advantage:

1. Expanding services to existing clients – companies may concentrate on offering additional services to their clients because they generate income and allow company to grow.
2. Concentrating on high potential clients – the approach implies that company should find new developing clients that have high potential and that can be served by the company. There may be different strategies to determination of potential but the most common are growth rate, profit, state of relationships with current service provider, prospects of the industry and so on.
3. Enhancing referrals – it is in interest of every firm to gather professional referrals as they may help a lot to get new clients. It is important to identify those companies, referrals of which may be valuable in future (for example, identify company’s potential to grow).
4. Reputation program – company should work on its reputation. The initial stage is to create and maintain a good public image.
5. Market specialization gives a service provider wide opportunities to attract new clients because it will be perceived as a professional in a specific area having expertise and to decrease costs of providing a service as the volume increases.

It is essential to mention that services need different advertising comparing with manufacturing companies because of intangible and transience nature. So the greater emphasis should be put on communicational aspect and emotions which derived from visual part of advertising. The important concept that emerges in service marketing is relationship marketing. Its efforts are put into development of long-term relations and loyalty. In terms of service providers, clients are involved in relations with companies while the latter provide client with bonuses. According to Price and Arnould (1999), clients perceive loyalty, recommendations and sense of friendship as related subjects and project all of those to a company. On the other hand, companies are loyal to customer as well when they are willing to continue relations and ready to be more engaged and put more effort to keep on servicing the client. In this case, word-of-mouth is an important communication channel. Opinion is usually transmitted via internet or oral conversation by customers or opinion leaders, namely experts of the market, who play the role of intermediaries between message receiver and a company. But nowadays another channel exists – social media. It helps to create a debate regarding service provision in which anyone can take part. Research of Switala (2013) shows that internet is the most influential channel for service providers. Internet can be used not only for word-of-mouth practice, but also for various activities, such as websites, blogs, article publishing, video channels, services’ networks, forums and directories, banner advertising, etc.

Verbauskiene and Griesiene (2014) use another marketing approach – experience marketing which emphasizes customer’s experience and feelings of a brand while making possible to participate in brand development. To some extent, it resembles relationship marketing by using communications, relations and loyalty. But in this case, relations are required to form experience regarding service usage. Experience is considered as “the result of combination, which consists of customer cognitive, action, emotional, social or physical response received during participation and interaction with the process of service provision” (Verbauskiene and Griesiene, 2014). In order to implement the strategy, company should identify the following: analyze the experience level that exists (first time user, or some experience, or an experienced user); then identify consumption stage (considers purchasing, ready to purchase, purchased); with regard to this information, the decision of what strategy to apply should be made. It is necessary to remember that emphasis should be made on emotional factors, not only physical benefits.

Another marketing activity that should be actively used by service providers is direct marketing. It allows to create and improve brand awareness, manage customer loyalty and communicate directly with client. Direct marketing is a two-way cooperation between firm and client that creates a personalized interaction. This form of marketing can be used regarding the place by many means of communication, which decreases costs and allows fast responses. It is easy to track marketing performance by introducing such criteria as return on marketing investments, response rate, etc. to identify its feasibility. Thwaites and Lee (1994) identify the following applications for direct marketing for professional service providers:

* Making customer loyal to a service
* Cross-selling and up-selling to a client
* Increasing of income from additional sales
* Promoting new services

Kumar et al. (2014) argue that consumer satisfaction in service industries depends on 3 main factors: technical service quality (refers to “the quality of what a customer actually receives as a result of interaction with service provider”), functional service quality (refers to the extent to which a customer gets the result of service usage) and corporate image. Clients take into account those dimensions and customer experience, and form perception of a company.

Nowadays service providers are extremely tied to information technologies due to the fact that service companies are selling their skills and knowledge (Bahl & Wali, 2013). And one of the main issues that service companies should protect is their knowledge base. Consequently, IT security is of great concern. Security is a part of overall quality of an organization because information leakages appear not only because of IT faults but also because of insufficient corporate governance (Bahl & Wali, 2013). What’s more, Internet is the major factor of marketing activities development and improved communication with customers. Communication is extremely important because customers’ engagement can make them co-creators of a service.

Luo and Deng (2009) argue that strategic alliances and cooperation are becoming the most usable forms of companies’ cooperation in knowledge-based markets because learning and innovations are accumulated in networks, not in each company separately. Torkelli et al. ( 2012) state that networking capability is one of the factors that can lead to competitive advantage as it develops competences and improves performance In service area, partnership has several positive effects. To start with, similarity can decrease coordination investments due to comparable organizational routines and “mutual identification” which allows to create better informational exchange culture (Luo & Deng, 2009) while generally, coordination investments are increased in cooperation. What’s more, routines can improve communication between organizations which improves pace of technological development. Similar firms can more effectively use knowledge and skills of a partner because their own knowledge is usually interrelated and mostly intersected. Consequently, it is much easier to codify the knowledge and integrate it into company’s culture. Alliances merge resources which make advertising more affordable than that of a single company because it is easier to establish professional marketing campaign for a group of companies. Customers expect companies to improve quality and, as stated before, in certain environment, alliances’ service quality is improved which leads to enhanced customer satisfaction. Mason (1993) generalizes advantages to the following features:

* Excess capacity is changed to increase of income
* Economy of scale
* Entry costs and risk reduction when participating in new markets
* Enlarge existing services
* Increase rate of service launches

However, there are several issues that may make the alliance inefficient for participants. For example, companies should identify what knowledge to share with competitors because extensive collaboration can be harmful for its business as firms share physical assets and knowledge they have, which will lead to decrease of competitive advantage. Another reason is that companies may contribute too little if participants are similar because the knowledge and skills they bring, can be not enough to satisfy other’s needs. Luo and Deng (2009) conclude that companies with complementary resources create synergy and enhance performance of each other. It is also necessary to determine the number of similar partners in alliances because involvement of each additional similar company decreases new knowledge, added to the network due to already acquired patterns on which the cooperation between new and existing partners is grounded. It is possible to state that collaboration between similar partners can be based on one of two trade-offs: between competition and collaboration; between knowledge variety and absorbing capability.

Raue and Wallenburg (2013) identify the factor that improves performance of service provider as horizontal cooperation between companies. This issue is quiet complicated because companies understand that they are competitors while functioning for the joint activities. It is also stated that cooperating companies should be similar on certain factors and be different in others in order to provide value to each other. Speaking about similarity, Kale et al. (2000) identify that geographical, competence and cultural similarity are important for service companies’ cooperation. Also the researchers state that cooperation commitment (willingness of companies to continue relations) and cooperation innovativeness (ability to develop services or to invent new ones) are crucial for development of horizontal cooperation. The research of Raue and Wallenburg (2013) shows that innovative activity is prevailing in broad cooperations than in focused ones but broad cooperation are associated with increased complexity. However, Bell et al. (2006) argue that horizontal cooperation may face some difficulties if companies possess similar resources which make them compete while not fulfilling needs of each other and not providing additional knowledge that prevents cooperation from mutual learning. Luo and Deng (2009) mention that this cooperation may be positive depending on how competition between parties can be fruitful for cooperation and what is the relationship between other similar companies and the leading company in the cooperation.

Company’s size may be important because study of Sharma and Hosie (2015) shows that size of a service provider has a positive relation with reputation and customer expectations. Clients usually don’t have ability or knowledge to identify internal aspects that affect service companies and rely on subjective measurements such as ranking. However, there are industries (for example, audit) where service provider’s activity is regulated by the government and this may guarantee minimum service quality level which makes company’s size relatively unimportant. However, client’s company size is also a significant factor because big clients usually expect enhanced quality of a service due to relatively higher importance of those services. Big clients also expect assistance of senior management and greater attention (Reynolds & Francis, 2000). On the other hand, the minimum service quality expected by companies is established by contract conditions or generic business norms. It is necessary to mention that size of both sides of business are important and have positive influence on each other.

Market specialization is used by some professional service providers in order to deliver more value to client. Whenever a company implement this strategy, reputation increases due to specific knowledge that the company has in market segment. It is referred to both perceived by clients and professionals. Another issue is that company restructures itself to put emphasis on this segment. It allows interested client to have access to employees who are responsible for this service and have required experience and knowledge while establishing more engaged relations. It is mentioned by Beaton and Beaton (1995) that specialization can be relevant to tie client to the company and its services, and enhanced knowledge of customer’s firm acquires such value for both customer and the firm that it is not possible to break up those relationships without making harm to each other.

According to RBV, companies need specific resources to provide additional services while involvement into too many services can lead to decrease of resources’ importance. However, company can achieve competitive advantage when it allocates proper resources to diversification, but it may lose an established position if there is excessive number of services offer that do not correspond to resources’ availability. When a company diversifies its activities, new business units are created. Sometimes, they may be hard to coordinate activity because of complex processes and diverse areas involved. Giachetti (2012) finds the positive relationship between experience of a company and diversification which means that the more experience a company has, the easier it is to manage the company and the better is performance of the company. RBV also states that companies more probably diversify its activity if resources are underused that usually consists of intangible and knowledge-based resources and capabilities. Another important issue is how to address these services to clients because involvement in different areas requires efforts and expertise in them. Giachetti (2012) defines three main advantages of diversification. To start with, development of underused capabilities is important because service providers acquire new knowledge and skills associated with specific area. Over time, companies learn how to use their underused capabilities in efficient way. Another reason is that entering new related services can evoke knowledge sharing. It may be useful for management to identify what those services have in common in order to define the ground for competitive strategy. Synergy may appear between core service and related services which improves overall business performance. Company can interest new customers or offer wider service range, providing a bundle of products for existing customer. The degree of diversification plays important role and that is why concepts of “related diversifiers” and “unrelated diversifiers” emerge (Sheu et al., 2006). Researchers agree that related diversification creates synergy, which is associated with better performance.

Dekimpe et al. (2016) add that financial crisis affects service providers more than manufacturing companies because service cannot be kept in time by a company or by a customer that results in drop of demand. In addition, if demand falls, amount of work for employees will be reduced which leads to higher employee turnover. In service industries labor is more important than in manufacturing; that is why it may be hard to replace professionals that left the company.

In order to improve business performance of service providers, Dawson (2007) suggests that companies should implement the following activities:

* Resourcing. By this, the researcher means that it is essential to allocate resources in the optimal way. Effective usage of external resources and invitation of the best global talent is an obligatory condition to increase business performance. But also it is necessary to enhance resources locally and to retain the most expertized employees.
* Partnering. This aspect is extremely important because a service provider cannot be an expert in every area and in order to attract new clients it is possible to outsource a project to partner service provider. This will allow to expand product line while not loading company’s employees too much. If a company is able to create a system of collaboration with partners, it will benefit from satisfying customer needs regardless of location.
* Packaging. This issue is important in both manufacturing and service companies. Companies usually provide customized offers to every client and sometimes they don’t even use single pattern. Packaging in terms of service means transfer of one-time project to a repeated offer. By doing this, company gets adjust sales procedure that has more expected outcomes and may be used by new or existing clients. Dawson (2007) calls this process “productization.” This is useful because of several reasons:
  + Productization uses resources more efficiently;
  + Standardization of prices;
  + Simplification of process and ability to propose special offers to clients.
* Co-creating value. Knowledge-oriented service providers collaborate with other companies in order to improve capabilities. In this case, replication is almost inaccessible by rivals because it takes a lot of time to establish relationships and mutual understanding.

Based on analysis of sources of competitive advantage of professional service firms, it is possible to derive the following groups of sources: intangible factors that are associated with attitude towards a company of clients, marketing activity which involve several concepts of how to attract and sustain customers, IT that is required for everyday operations, networking that allows to share knowledge and skills and competitive strategy that defines on what a company should concentrate. All of those factors will be analysed in second part of literature review.

## 1.3 Competitive advantages on audit market

According to ISO 19011:2011 standard in a broad perspective “audit is the systematic, independent and documented process for obtaining audit evidence (such as records, statements or facts) and evaluating it objectively to determine the extent to which the audit criteria are fulfilled.” But the research is concentrated on audit in sense that it is an evaluation of financial indicators of a company in order to prove that all transactions are fair, accurate and don’t contradict to specific financial standards. The result of auditing is an auditor’s opinion regarding correctness of financial reporting. Audit is an important aspect of company’s performance as it helps to delete bias in financial statement. Audit is a seasonal service with one-year contract and the peak of checking occurs on March. There are also nine-month auditing, so auditor companies receive profits once a year. Auditing activity is based on Professional Standards for performing auditing activities in the Russian Federation elaborated by Ministry of Finance of Russia.

Two types of audit exist – obligatory and initiative. Initiative audit is received based on contract terms which imply time of auditing, goals and volumes of activity. This procedure is implemented based on willingness of company’s owner or shareholders. Obligatory audit is an annual procedure of checking financial and accounting reporting of a private entrepreneur or a legal entity. In Russia there is a number of companies that are obligatory audited:

* Financial criteria. Earnings exceed 400 million rubles or amount of assets exceeds 60 million rubles
* Legal forms. All types of Joint stock companies and state or municipal enterprises.
* Activity basis. All these companies are audited – insurance companies, professional participants of securities market, credit organizations, stock exchanges, private pension funds, non-profit organizations and charitable institutions
* Specifics of activity. Companies that are providing consolidated report or that are allowed to trade their stocks on security market.

Another classification is based on auditor’s connection with a company – internal and external. External auditing means that an auditor outside of a company is checking the company’s information in financial reports while internal auditing is implemented inside the organization by its employees based on desire of company’s owners. In this case, information received after audit is used by managers to improve internal procedures.

Usually a number of resources, which are identified in literature, can be summarized in following groups:

* Human resources which include existing employees, future requirements for staff, training and development procedures and outsourcing decision
* Intangible resources include reputation, brand value, goodwill and intellectual property rights
* Financial resources include existing budget and expected funds
* Physical resources such as equipment, offices, network servers information technologies, marketing procedures

Quality of audit is perceived differently by different stakeholder groups. As for users of audit reports, they think that if the report does not contain important inexactitudes, than it is considered to be qualitative. Audit firms believe that audit is of high quality if the report can resist a lawsuit (Hu, 2015). In auditor’s perspective, high quality can be achieved by stating precise tasks by the audit firm. For control institutions, high quality means compliance of all standards. For society it may be qualitative if lawsuits are avoided.

Knechel et al. (2013) define the most important aspects of audit quality:

* Incentive means that the idea of audit lies in area of response to economical risk
* Uncertainty means that outcomes of audit report cannot be seen
* Uniqueness stands for the fact that the every contract is unique
* Process refers to continuous systematic nature of audit
* Professional judgment plays important role and requires a lot of knowledge to make a qualitative report

Even though competitive advantages of service companies are identified, it is necessary to expand the literature analysis concentrating on audit service provision only. In order to identify competitive advantages of an audit market, it is necessary to determine features of the market. European market is highly concentrated because of existence of so called ‘Big Four’ companies (Deloitte, Ernst & Young, KPMG and PwC) that occupy more than 60% of the world market (Velte & Stiglbauer, 2012). The researchers define characteristics of the audit market:

* Decreasing incentives to provide qualitative services
* Increasing entry barriers for medium and small companies, high entry costs and a long payback period
* Increasing influence of Big Four on international audit standards
* High market dependence on Big Four companies because if one of them leave the market, it will cause a problem of a choice for clients and loss of reputation
* High market concentration.

Consequently, the power of Big Four companies is increasing and clients prefer those companies to smaller ones because of expected quality and due to company’s reputation (Rama & Read, 2006). Also, Velte and Stiglbauer (2012) state that as a result of those processes, “small and medium audit firms are increasingly driven out from the market which leads to significant disadvantages of competition along with rising oligopolistic rents for big audit firms.” Due to big size and economy of scale, Big Four are able to provide many services to big clients. These clients prefer Big Four also due to organized international audit network which helps to transfer resources and share technologies relatively quickly. Big Four also in favour of local companies as they possess profound knowledge regarding practices in different markets, excellent known brand, developed methodology, well-educated and further trained personnel.

Medium size audit firms reach more expertise than small companies and that is why they are able to provide services to small firms and for larger clients. Comparing with Big Four, mid-size and especially small firms decrease operational costs because they don’t invest so much into resources that leaders concentrate on. However, they offer higher salaries for employees than small companies can afford and provide more prospects for career development. Also it is easier to become a member of medium size firm than that of Big Four.

Small companies’ access to financial resources is limited and they have to lower price in order to increase its market share. This is done by combining resources that lead to decrease of operational costs – simple IT solutions, salaries that are lower than that of mid-size firms and concentrate on working as subcontractors to get more clients. Kee and Patel (2011) mention that the largest percentage of costs relates to personnel wages.

Bills et al. (2016) suggest that several reasons of difference between small and medium size companies and market leaders exist. To begin with, number of these companies that provide audit services is much higher. It means that these auditors have to put more efforts in how to make themselves different from competitors. Another reason is that small and mid-size auditors possess fewer resources than market leaders which force them to focus on a specific industry. It is also necessary to mention that usually national competition is discussed while medium size companies don’t have enough resources and reputation to compete on national level with Big Four. However, if we take regional level, it is easier to build brand awareness and reputation and it requires less resources. So local competition should be considered as different market environment comparing with national market.

However, it is possible to divide market in two parts by observing their investment behaviour (Sirois et al., 2011) – Big Four and other companies. These two groups show different patterns towards investments in audit technologies (which is thought as a factor that increases economy of scale). For example, Big Four tend to invest more (it is companies’ differentiation strategy – by investing in technologies, they can improve value by enhancing quality). This investment decreases fees on local markets while fees of other market participants remain the same (Sirois et al., 2011).

Some researchers rely on general competitive advantage theories. Casterella et al. (2004) state that if we assume that the market is homogeneous and switching costs are low, then audit firms must be involved in price competition. However, another option is to differentiate a company from competitors. On the market, audit firm gains fee premium when buyers value this differentiation. What is more important, increased value means increased switching costs for audit clients that can be used to charge higher prices. Casterella et al. (2004) provide example of this situation. In 1980s audit market’s rents were low because of price competition but then, in 1990s, companies started to implement differentiation strategy grounded on their experience and knowledge.

Carcello et al. (1992) argue that differentiation by itself is useless unless a client gets value out of auditor’s expertise. Also, the researchers point out that for clients the most important factor by which they choose an audit company is experience and knowledge of personnel.

Client’s influence plays a great role on the audit market - powerful audit clients can exert pressure on auditors. However, in this case, profit-oriented companies can reduce the quality of audit or they will lose some part of their profit. Bargaining power, according to Casterella et al. (2004), is the factor that is important in the industry because clients with higher bargaining power are more important to auditors and they are able to negotiate prices. Vice versa, small clients are usually price takers. However, a client may be rather small but generate large percentage of profit for an audit company – this is called relative size (Casterella et al., 2004). Maijoor and Van Witteloostuijn (1997) argue that large clients can be audited only by large audit firms. That is due to increased number of hours an auditor must spend to work with all branches but also because an audit company may become dependent on big clients and cannot overcome pressure. The conclusion is: the much qualitative audit is, the more independent is a company. Bandyopadhyay and Kao (2004) indicate that medium-size companies have more local clients than big audit companies have. This is because medium clients usually perceive auditor’s location as one of the main reasons to contact the company (Carrera et al., 2003). However, in terms of big auditors, they benefit of being presented in local areas if their clients also have business in this region.

Audit fee premium for industry specialization is an important consideration on the market. Casterella et al. (2004) find out that companies tend to charge higher fee for clients that are relatively low in size, but the fee is reducing while the size of a client is increasing. For clients which assets are more than $123 million, there is even no price premium for industry specialization. Consequently, specialization fee strategy is under concern because it is charged mainly to small clients. It also adds additional costs to overall performance due to increase in costs of training for personnel. In order to return those spendings, it is necessary to increase fees on all audit activities performed. What is more important, while a firm will concentrate on special areas, standard auditing will be unchanged in terms of quality (Casterella et al., 2004). The pattern of audit fee in relation to size of both clients and auditors is also investigated by Palmrose (1986). She identifies that for Big Four companies the following propositions are correct: those companies charge higher fee because of higher market power and because of better quality of audit services. Simunic (1984) studies another important issue – relation of sum of non-audit services and audit services to fee premium paid. It is identified that customers that order not only audit but also additional services, pay more than those that purchase audit only.

However, audit fees are reduced on homogeneous industries. It is due to the fact that firms’ operations are similar to some extent, so auditor’s knowledge regarding industry is already acquired for all companies and goes from one firm to another (Cairney & Stewart, 2015). The industries may be unregulated or regulated with no difference in this specific issue. Efficiency is gained through knowledge, reduced working hours required and external monitoring of the industry. This leads to decrease of fees as auditor efforts are reduced.

Bills et al. (2016) argue that large companies pay more attention to its mid-size competitors than other market leaders in terms of audit fees. As was identified previously, mid-size companies compete mainly in regional markets. While the competitive distance between an auditor and its closest rival is increasing, audit fee difference is rising. At the same time, audit fee difference between mid-size and a market leader is reducing. It is explained by perception that pressure from auditor’s competitor decreases and this auditor perceive himself closer to big companies and starts to correlate audit fee to that of leaders.

Another way of finding competitive advantage is proposed by Einchenseher and Danos (1981). These researchers state that investing money in personnel can be the reason to “redesign of the audit process custom-tailored to specific industries”. This procedure has two positive outcomes – it develops audit quality and makes audit efficient. Consequently, efficiency will provide lower prices for clients that creates competitive advantage not only in terms of differentiation (audit quality) but also in terms of low costs. The factor that is related a lot to human capital is knowledge management. Mignon and Janicot (2009) refer to it as a key factor in achieving competitive advantage for audit companies. However, to set up a knowledge management system it is necessary to meet several criteria. Mignon and Janicot (2009) define the most important aspects of audit market regarding knowledge management:

* Employees’ skills are grounded on knowledge that can be formal (organizational routines, new technologies and tools) and informal (experience, networking and knowledge acquired from other firms) and is used during execution of audit activities.
* Audit firms target to receive critical size that leads to concentration of the market. The main goal is to increase client base and to expand firm’s activity to different areas.
* Companies should make knowledge an organizational routine rather than individual to avoid strong dependency on employees.
* It is also necessary to enhance auditing practices.

Single auditor’s experience is something that definitely should be considered. While implementing audit and writing the report, the professional “recalls information necessary to perform task from memory” (Cahan & Sun, 2015). And quality of reports depends on the accuracy of recalled information. The more experience an auditor has, the better and more accurate report is done. Moreover, experience helps auditor to choose information that is necessary and to weight importance of it. It means that knowledge affects precision of audit judgment.

Reputation is another factor that affects client’s decision. DeFond and Zhang (2014) suggest that reputational capital is one of the main factors that can help to build and extent client base. Employers are interested in audit professionals not only because of gaining market share but also to avoid fee for inappropriate audit procedures. As a company’s reputation is at stake, it is in interest of a company to assure that audit quality is at high level (Srinivasan, 2005). Reputation is fragile to hostile reviews because clients perceive peer reviews as a valid and reliable source of information about quality of audit (Hilary & Lennox, 2005). Clients tend to pay attention to publicly available sources of information about companies that is why reputation of local offices is important as much as the general company’s reputation (Swanquist and Whited, 2015).

Marketing is a source of competitive advantage that audit companies use by utilizing existing relationships with clients. Relationship marketing is one of the most important aspects as it allows to identify client needs and satisfy them. Long-term fruitful relations are the key to performance improvement due to two factors – purchases are made by an existing customer during period of relations and willingness to order supplementary services because of trust in the auditor. Due to unstable economic situation, auditors need to save existing customer base, which can be implemented through relationship marketing. What is more important is that when companies involve clients into learning process, clients can increase value of a service that they order. However, it is important to remember about classical marketing channels such as direct marketing because it provides emotional connection and sense of care for clients. Companies should put a lot of efforts and investment in increasing customer value and retention because this focus leads to sustainable competitive advantage even though companies need to possess specific knowledge of how to establish and proceed with the relationships.

Another important issue with regard to marketing is branding. This strategy is especially important in such intangible market as audit because customers base their decisions about service provider choice. Brand is essential mean of communication as it provides information that cannot be gathered before the service is ordered, such as experience, and shows company’s reputation. Audit companies can effectively use combination of branding and Internet activity by utilizing word-of-mouth. The required information can be gathered on website or social media while take few efforts from client and they may use the indirect feedback as a factor to form opinion regarding a company.

Carrera et al. (2003) state that revenue is achieved by performance in two main markets: audit and consulting. However, it is argues by Causholli et al. (2014) that non-audit services should be carefully implemented as they may lead to decrease of audit service’s quality. It is obvious that companies want to increase their income and one of the ways how to do it is to involve into additional services’ activity. Researchers identify that in some settings these activities can affect objectivity and “compromise auditor’s independence from non-audit services when auditing small, high-growth clients (Causholli et al., 2014).” It may appear that in certain point auditors will base their decisions on economic outcome of providing additional services despite of concentrating on reputation or legal issues. What is more, independence of auditor can be vanished by incentive to get an order for additional service from company’s client in future. Consequences of this is significant decrease of primary activity – auditing.

Carrera et al. (2003) mention that companies can decide to implement differentiation strategy, particularly, to specify on client’s industry. The segments which a company wants to enter are related to company’s size. Another option is to concentrate on decentralization and a specific geographical market in order to be closer to potential customers. By doing this, auditor achieves better reputation, decrease of contractual costs and becomes more efficient due to closeness to customers. As a way to implement this strategy, it is possible to use mergers and acquisitions to increase market share in various local markets. Companies that use this strategy can benefit in several factors. Auditor’s efforts are decreased because the resources are moved closer to client. The quality is improved because of “proximity of staff and offices to the clients’ location” (Carrera et al, 2003).

Mergers in market are common issue. Mergers are positive because of decrease of audit efforts that is associated with decrease in audit implementation time (Gong et al., 2016). It is important to mention that there is no correlation between lower audit efforts with audit quality. In fact, merger of resources is fruitful in “lower probability of financial restatement, higher probability of modified audit opinions, lower probability of small earning surprises and more conservative reporting” (Gong et al., 2016). The explanation is that during mergers companies share their resources, which leads to improved efficiency, and the synergy effects starts to work. The bigger a merged company becomes, the more benefits it gets in terms of saving time on implementing audit. Another advantage is that this process leads to decrease of audit fees because reduction of audit efforts affects prices that are offered to clients. On the other hand, the reduction in prices usually is avoided because when company is becoming larger, it has more market power and reputation that allows to charge higher fees. However, it is argued by Deng et al. (2014) that mergers are not always positive because they can reduce accuracy of information which affects audit quality. If we take companies of different size, their information flow can be less productive than in one large company because of reduced information quality. From economic perspective, costs associated with merge can exceed advantages and it may not be reasonable to unite two companies.

Nowadays, audit outsource is a common procedure when relatively big companies outsource their audit activities to smaller firms. In this case, principal auditor should evaluate the risk of audit failure of another auditor which will lead to decrease of reputation and costs of lawsuit (Dee et al., 2015). CEO of a client firm may reject to use services of an auditor that has disclosed the use of an outside auditor because of possibility of failure and low quality.

Sometimes companies also use services of joint engagement auditors, which means auditing by several partners. This kind of work has many advantages such as difficult audit task because of client’s features, social closeness of co-workers that leads to more efficient involvement of parties due to more efficient interaction and acquisition of relevant audit evidences, merger of two main aspects of auditor’s activity – competence and independence (they are addressed by the improvement of procedure by benchmarking decisions against those of the other engaged auditor), peer review and communication. All of these aspect result in better quality provided (Ittonen & Tronnes, 2015). However, this collaboration incurs a lot of risks. Zerni et al. (2012) state that lack of information exchange, more difficult management of the partners (because of requirement to hide their companies’ secrets) and difference in shares can lead to failure of joint engagement. Gonthier-Besacier and Schatt (2007) add that “overlapping procedures” are cause of failure as well. Ittonen and Tronnes (2015) conclude that this way of working is a competitive advantage but an auditor should carefully choose the partner to benefit from cooperation in terms of efficiency and decrease of costs and to be more attractive to a client.

Carson and Dowling (2012) identify opportunity for an audit company that is related to technological development – audit supporting system. It integrates decision aids and knowledge banks of a company in order to manage company’s methodology and improve efficiency of audit. Dowling and Leech (2007) mention that audit companies have different systems of audit service. The most structured ones tend to provide stability and enhance methodology by automatization while less structured firms use manual systems. Audit supporting system is important because it gather all the knowledge a company possesses and allows to use the knowledge in the most efficient way. However, Carson and Dowling (2012) mention that the relation between audit supporting systems depends on local market environment and the system’s effect may be different in different settings. Dopuch et al. (2003) argue that audit service cannot be unified across different clients due to the fact that client’s environment is an important factor for auditors. Higgins et al. (2016) add to the point of importance of supporting systems that technological advancement of a company may be a competitive advantage (no matter if a company competes by using low cost or differentiation strategy). Even though introduction of a new supporting system cannot change process of audit, it obliges auditor to see to what extent company’s procedures are changed and what are the risks associated with it (Jackson, 2013). The researcher argues that every change is important and significant, so drawbacks of implementation should be identified.

Nowadays, companies are using IFRS as a competitive advantage (Higgins et al., 2016). IFRS (International Financial Reporting Standard) were implemented to unify reporting standards worldwide for understanding accounts of a company abroad. Those standards are essential for companies that have subsidiaries in foreign countries. Also, IFRS increases transparency of company’s activities to decrease informational gap among stakeholders. Another advantage is that IFRS helps investors to see opportunities and threats which make capital investments more efficient. For audit companies implementation of IFRS standards is an advantage (Barth et al., 2008), though additional costs are incurred from this process. The interesting finding is that first adopters of IFRS set higher fees for clients after adoption and further save the fee level - this can be explained by higher costs involved. However, Barth et al. (2008) find that first adopters’ costs are similar to costs of later IFRS adopters, so the price premium is set for competitive advantage early adopters get. The fees may be higher if those companies invest in quality of reporting which requires better audit control.

As was mentioned previously, IFRS audit requires more efforts from auditors but it is also more complex procedure, has more regulations and involves more risk (Kim et al., 2012). Due to the fact that early adopters charge higher fees after implementation of IFRS and they also have high premium before implementation, Higgins et al., (2016) suggest that these companies can be rather large in terms of size or companies that are willing to invest heavily in quality of audit. IFRS investments trigger increase of audit fees but they also increase barriers to entry. IFRS development is connected to audit supporting systems because these systems help to answer the enhanced quality efforts.

In scientific literature researchers attempt to identify core competences of audit market. Gimzauskiene and Staliuniene (2010) derive that those competences are important for the industry (they are placed in descending order):

1. Acceptance and continuance of relationship with clients
2. Consultation, review and discussion about job performed
3. Performance of special audit engagements
4. Proper monitoring of audit quality
5. Direction, supervision and performance of the audit procedures
6. Assignment of audit teams
7. Development of the audit report.

It is mentioned by Gimzauskiene and Staliuniene (2010) that set of competences depends on structure, opportunities and resources each company possesses. Consequently, different services require different composition of competences at different point of time and it is not obvious which of the competences above should be treated as core competences and which of those should be complementary without internal analysis of resources and capabilities.

Another issue regarding competitive analysis raised by Chan et al. (2001) is that company’s success should be measured not on national level but on local because accessibility of personnel is different in different areas because companies compete in neighbourhood and only these measurements are adequate representation of market power. Chan et al. (2001) also stress attention on concentration on the market. This aspect is important to analyse locally because concentration is different on local markets. Bandyopadhyay and Kao (2001) find out that the higher concentration is, the higher audit fee is. Audit fees can show company’s market position (the higher the fee is, the stronger the company is on the market).

To conclude, during literature review of professional service providers, five groups sources of competitive advantages are identified – intangible, IT, marketing, strategic and networks. These factors are proven during analysis of auditors to be applicable to audit industry (Table 1). However, they have slightly different content. In professional services relational aspect and customer engagement are important, in audit market the client’s influence (Maijoor & Van Witteloostuijn, 1997), experience of auditor (Cahan & Sun, 2015) are of great importance while reputation and personnel quality are equally important. In marketing professional service providers involve customers a lot by using relations and experience, audit companies rely on direct marketing, internet promotion and branding activities. Work of an auditor cannot be done without professional software; that is why emphasis is put on supporting IT solutions (Carson & Dowling, 2012). In literature regarding cooperation, two main points are identified: mergers (Gong et al., 2016) and joint engagement practices, which mean that several auditors perform a task requiring more efforts (Ittonen & Tronnes, 2015; Zerni et al., 2012). Audit companies use common strategies such as specialization on client’s industry (Carrera et al., 2003) or differentiation and provision of non-audit services (Causholli et al., 2014; Carrera et al., 2003).

The further analysis is based on these sources of competitive advantage and their applicability and relevance to Russian context is identified in following chapters.

Table 1

Sources of competitive advantages of audit firm

|  |  |
| --- | --- |
| **Factor** | **Audit** |
| Intangible | Client’s influence |
| Human Resources |
| Reputation |
| Auditor’s experience |
| Marketing | Direct marketing |
| Internet activity |
| Branding |
| IT | Audit supporting system |
| Networks | Merger |
| Joint engagement auditors |
| Competitive strategy | Specify on client’s industry |
| Differentiation |
| Cost advantage |

## Summary

In Chapter I existing literature regarding several aspects are analyzed:

* Theory of competitive advantages is discussed and its general sources are mentioned
* Specifics of professional service providers and sources of competitive advantage that they possess are defined
* Specifics of audit firms and their competitive advantages are analyzed

The literature review is based on Resource Based View, which is a viable framework for analyzing firm’s competitive advantage. Afterwards it was identified that audit firms are included into group of service companies – professional service providers, and their sources of competitive advantages are studied. Based on this information, direction of further research is identified and sources of competitive advantages that exist for audit companies are stated. These sources will be used to specify the most relevant strategy in Russian context. It was also found that lack of research for small audit companies exists in previous studies so the main emphasis in this paper is made on this group of companies.

# **Chapter II. Methodology**

## 2.1 Method

Firstly, it is necessary to identify research type - this research is exploratory (Robson, 2002). It means that the purpose of the research is to get new insights, to assess the phenomenon and understand its current condition. The advantage of exploratory approach is that researcher can change direction of the research when new data are gathered. Consequently, this flexibility leads to better understanding of the topic and the ability to improve final research hypotheses to be suitable for real life implementation (Adams & Schvaneveldt, 1991). It means that at the beginning the research topic is quiet broad but with the development of information it becomes narrower.

After understanding the research type, it is necessary to identify the research strategy. In the terms of this research, it is the case study. Case study “focuses on understanding the dynamics present within single setting” (Eisenhardt, 1989). This strategy is chosen because it observers an existing phenomenon, which consists of several variables of potential importance, and investigates it in real environment while results of findings are used for generalization. Because audit market condition and interactions are of great importance, case study allows to pay attention to context and involves it in the research. For example, in this case market environment provides relevant difference – during crisis volume of services decreases which affects strategy that should be implemented by auditor while in time of economic advancement the demand for service is increasing as well as demand for specific supplementary services. Case study provides not only the understanding of environment but also of processes being enacted and opportunity to learn personal attitudes and interpretation of interviewees. The method is useful to describe the context, explore the data and to illustrate complexities that occur on the audit market. The questions asked by case study are “how” and “why” and they are asked about a series of events which researcher does not control. “How” questions are important because they provide understanding of the market from perspective of interviewees. Data will be collected by interviewing an expert in audit area.

The method that is used for the research is multiple case study. The main idea of this method is to find similarities within chosen cases. The advantage of multiple case study to single is that the latter takes into account only one case (unique or extreme) which may not enough to explain settings of a specific industry. Multiple case study is a useful tool to make analysis of environment, which is better understood by looking across various settings (Yin, 2003), and to replicate results within the cases. A multiple case study enables the researcher to explore differences within and between cases. The goal is to replicate findings across cases. Because comparisons will be drawn, it is imperative that the cases are chosen carefully so that the researcher can predict similar results across cases, or predict contrasting results based on a theory (Yin, 2003).

The multiple case study should be treated similarly to multiple experiment – instead of using results from one experiment, the main emphasis is on replication of experiment. This study needs several cases to see whether the outcomes are repeated or not. So if the result of most cases comes as predicted, the cases prove the initial propositions, otherwise research questions must be restated. During the discussion of results, it is necessary to determine condition when investigated phenomenon will appear and mention conditions under which it is not so widespread. Each time when expected outcomes don’t match the result, it should be noted in theory.

This is the inductive case study which is used to build a theoretical framework from data gathered. The case study was chosen also because the research question is closely connected to existing theory but expands existing findings. Literature does not totally explain the issue while the question of competition is of great importance for small size audit companies. The research is useful for both theory building and practical perspectives. In this case, qualitative data is required to provide sufficient background for thesis purposes.

Triangulation is an important aspect of a case study research. It means that several sources of information are utilized during the research to prove that its outcomes are valid because different data collection methods give similar results. One of the main disadvantages of a case study is the bias that occurs. However, triangulation allows overcoming it due to combination of empirical data, theoretical findings and methods which improve reliability of research. The type of triangulation used is methodological, which means that multiple data collection methods are included into research such as interview, secondary sources, and questionnaires. During the research, these methods are used.

Because of high time constraints, the research is cross-sectional (Saunder et al., 2009). It means that phenomenon is observed at a particular time. The most common methods of cross-sectional study are interviews which are short-term oriented. However, it is always possible to use mixture with longitudinal approach as an addition to cross-sectional. For example, secondary data (such as already conducted interviews) will be used to make the study more extended in time. Already implemented interviews are used in order to limit bias and view the research using different opinions. It is important to mention that interviews must be topical to add value to the research.

## 2.2 Steps of research

The first step is to conduct pilot interview with the owner of a small audit company. Pilot case is used to develop research area, specify propositions and improve relevance of questions asked. Pilot interview is important to researcher and may be a prototype for real case study even with the same interviewee. This was done by contacting a person in Siberian region. Due to her assistance, it became possible to restate question from interview and get a lot of insights about audit market. It is important to mention that final interviews are semi-structured because there is a list of questions that the researcher needs to ask but the details may differ from interview to interview. Because of specifics of every organization, questions may have different order or additional questions may be asked in order to understand the organization better. One of the main advantages of qualitative research is that it generates opinion of experts in a certain industry. What is more, for research it is possible to determine social issues that affect the industry. Qualitative questions may evoke unexpected answers that can improve relevance of research.

After conducting preliminary interview and reformulating the research questions, the final interviews are held. Interviewees are top or middle level managers of small audit companies (the size is defined by categories by Ministry of Finance (2016) – there are less than 15 auditors with professional certificate in small companies, from 15 to 50 – midsize company and big firms have more than 50 employees with the required certificate). The information is gathered through direct interviews, phone calls and in written form. For the interviews, a questionnaire is created (Appendix 1) and used during discussion with auditors. It has three parts – during the first part interviewees speak about general state of Russian audit market, its reaction to economic crisis and effect of international companies; the second part of questions refer to differences between regions and future predictions of the Russian audit market’s behavior; the last part is based on the sources of competitive advantages which were identified in literature review part of this paper.

When the interviews are conducted, materials from open sources are used in order to get more insights about the research area. These are interviews which were conducted several years ago and that are discussing the issue of audit company’s development. They are valuable for gathering more information before deriving conclusion of the research.

The final step of the research is to gather all data and use them to make a final framework. This stage completely depends on previous – if researcher keeps up with the frame of research, it will be easy to consolidate the data together and interpret findings in single manner.

## 2.3 Analysis of interviews

After information is gathered, it is necessary to analyze it and to derive conclusions from the research. For this purpose the grounded theory was chosen. Grounded theory is developed by Corbin and Strauss (1990). The main ideas of the research are:

* Analysis begins after the first information is gathered – this guarantee that researcher will add important aspects during research
* Sampling is based on theoretical grounds which means that the typical representative of a phenomena studied is taken as a sample
* Patterns are built on regularity of an issue
* Based on data analysis theoretical findings emerge.

It is possible to divide analysis in two parts:

1. Initial analysis. As was mentioned earlier, analysis starts right after the initial data were gathered. This technique is very useful because it provides an opportunity to redefine targets while getting more insights regarding the topic of study. It is necessary to start categorizing data as soon as possible in order to “capture all potentially relevant aspects as soon as they are perceived” (Strauss & Corbin, 1998).
2. Principal analysis. After all the data are gathered, it is necessary to process it for further analysis. For this purpose, content analysis technique is used, which is divided into several steps:

* To define unit of meaning. It is necessary to read through responses, identify expression of an idea and code the text of any size that has a complete insight. As the research is inductive the list of codes is created after all interviews are implemented.
* To categorize the data. The next step is to create broader categories that unite codes. It is important to constantly compare every code assigned to a group with already added to that group to better define the category itself or to join them if the meaning is similar.
* After categories are checked, the final themes emerge and researcher needs to analyze relationship between them and determine whether all of those codes were used by interviewees and how frequently.

## Summary

In this chapter methodology was analyzed. It started from general description of what is research about and then goes deeper into details to research method that includes many issues:

* Multiple case study is chosen as a research method
* The process of data collection is defined
* Requirements of which companies to choose are stated based on statistics of Ministry of Finance of Russia
* Content analysis as a way to analyze qualitative data process them into theoretical framework is used

In order to represent the way the research will be done, Figure 1 summarizes the overall path.

Figure 1. Methodology development process

# **Chapter III. Empirical study of competitive advantages of audit companies**

## 3.1 Market analysis

Every year Expert Rating Agency publishes the report about rating of audit consulting groups (ACG). Based on this report of 2016 by Expert RA, it is necessary to mention that total income of ACGs has increased to 22.17 billion rubles in 2016 which is equal to 6% increase comparing to 2015. It means that the market from stagnation (in 2014 nominal growth was 15% while inflation was 14%) went into recession of two consecutive years – 2015 and 2016. The worst dynamic was observed only in 2009-2010 years during the crisis (Figure 2). The situation nowadays is similar – in both cases companies have decreased investments in their development which results in unhealthy competition and dumping activity.

63% of total income – 13.95 billion rubles – is acquired from audit (including mandatory and initiative audit) while the remaining 37% of income are additional services, mostly consulting services. It is important to mention that income from consulting services in 2016 increases by 17% comparing with that of 2015, while audit income raise only by 0.5%.

Figure 2. Volume of income of audit companies

Source: data from Expert RA (2016)

In 2015 there were 91.6% of small companies, 7.2% of midsize and 1.2% of big audit firms. Despite high number of companies, small auditors have only 23.26% of market share, while market leaders have 65% of market. Sergey Nikiforov, CEO of FBK Povolzhie (2015), argues the market is monopolized. According to Ministry of Finance (2016) in 2015, there were 7.2% of companies that haven’t worked even a year on audit market, 14.1% have worked for 1-4 years and 78.7% worked for 5 years minimum. The market participants are experienced and entry barriers for newcomers are quiet high (one of reasons are government regulations) but it is still possible to start audit business, especially in regions.

E&Y is the leader in terms of revenue received from audit services – 5.44 billion rubles. The second place belongs to PwC with 2.6 billion. Data shows that E&Y and PwC together had a market share of 35% on audit services market. Deloitte and KPMG didn’t present data for the rating, consequently these companies are not included in the final rating but it is possible to assume that market share of Big Four is much higher. On the third place - Russian ACG BDO Unikon with revenue of 0.97 billion rubles which means 4.2% of market share. There are also 4 Russian companies that achieve market share of more than 1 percent – FBK Grant Thornton (2.9%), FinExpertisa (1.8%), RSM Rus (1.6%) and MEF-audit (1.1%). The market of audit services is highly saturated and the gap between Big Four and other companies is significant.

What is interesting, 58.3 billion rubles (64% of the net sales of ranking’s participants) in 2015 account for consulting services (Figure 3). Annual increase in revenue from consulting is 7%. For audit companies, demand for consulting services such as financial consulting, assets management, legal, tax and IT consulting helps to mitigate effect of crisis. The attention to supplementary services should be increased and companies, which want to be competitive, need to involve themselves into this market as trend shows stable development of the segment. However, it is important to determine economic condition – in crisis companies tend to spend more on financial and tax consulting in order to decrease tax burden and cost consulting to improve cost efficiency. At the same time, demand for such services as strategic planning is decreasing because companies do not want to spend money on improvements that will have effect in future. On the other side, during improvement of economic condition companies are interested in strategic development more than in cost consulting.

Figure 3. Growth rate of supplementary services

Source: data from Expert RA (2015)

Market analysis shows that nowadays audit market is a reflection of general economic situation and faces many problems (dominance of Big Four, strict regulations, decrease of income and decrease of number of clients). Mid-size and small companies are trying to close gap in revenues by providing additional services and working with local clients that are not serviced by Big Four. However, demand for services is affected by economic situation and this should be considered as one of factors when identifying on what services emphasis should be made.

Abaeva (2001) has investigated factors that affect the choice of audit provider in regional Russian market. Table 2 shows that clients mostly trust auditor’s competences and professional integrity, which can be summarized as professional qualities. Recommendations also play important role as well as costs, accuracy of information and knowledge of industry. These are the factors that companies should concentrate on in order to be perceived better on the market. Based on analysis of annual reports of Big Four, they emphasize efforts on the following issues:

* Acquisition of top talents
* Investments in education
* IT systems improvements
* Quality development
* International experience and famous clients
* Corporate culture
* Concentration on local market
* Emphasis on Corporate Social Responsibility

According to categories mentioned in Chapter I (Abaeva, 2001), Big Four meet customers’ expectations by developing competences that are required by the market – by having globally known clients Big Four have established positive reputation which is more increased by CSR strategy they implement, and knowledge, experience and audit culture is achieved through simultaneous development of human resources, IT systems and quality improvements.

Medium and small size companies cannot compete with Big Four in these areas as they don’t have enough resources. However, development of some of those competences can be set as a target because they will improve position of a company comparing to another company of similar size. For example, sharing recommendations from previous clients and being active in attracting new ones will increase perceived professional competence and clients will be more willing to choose this service provider. Customers also think that smaller auditor is more engaged with customer’s needs – auditor needs to make his job qualitatively as auditor’s reputation is at stake and once it is spoiled, it is hard to regain it. It is also possible to use advantage of being close to client and develop specific competences that are demanded by local customer concentrating on regional market where Big Four do not have presence and provide additional services that are required by customers. Another issue that can help small size companies to compete is to join professional groups in order to unite resources – by doing this a company is achieving processional status and its perceived competence level is increasing.

Table 2

Criteria of auditor’s choice

|  |  |
| --- | --- |
| Criteria | Percentage |
| 1. Professional competence:  * Auditor’s competence * Experience in specific area * Knowledge of industry | 61  21  48 |
| 1. Recommendations:  * Previous audits * From people whom management trust | 52  51 |
| 1. Job planning:  * Well organized plan of service * Accuracy and completeness of information | 9  49 |
| 1. Costs:  * Level of payments | 47 |
| 1. Professional integrity  * Confidentiality, honesty | 72 |
| 1. Company’s brand image  * Reputation in professional networks * Big clients * Published feedback from professionals | 39  45  12 |

*Description of small audit companies*

As it is mentioned in literature review (Kee & Patel, 2011), audit providers have different characteristics depending on their size. Usually, three main types are defined – large, medium and small. This research observes small companies, so it is necessary to figure out specific characteristics inherent to these companies. To start with, there is no strict formal distinction between size of companies, though, Ministry of Finance (2016) mentioned that number of employees with audit certificate should be from 3 to 15. Another option is to differentiate audit firms by annual income – it is less than 30 million rubles.

Based on the analysis of Ministry of Finance (2016), it is possible to define the following characteristics of this group of companies. They usually have 10-12 years of experience, 4-5 auditors in a company, 9 clients. It is also calculated that these companies gain 175 000 rubles from service to one client in Moscow and 96 000 rubles in other cities including Saint Petersburg. What is more, companies gain only 49% of income by rendering audit service.

However, more distinctive characteristics of small companies exist. During one of interviews, it was stated that small and medium enterprises prefer to use services of mid-size and small audit firms because they are not willing to pay more for services of similar quality comparing with big auditors, unless the audit is required for getting investment abroad. In small company, the distance between client and auditor is much lower than that of big and mid-size firms because they are more engaged in work and try to establish relations that are more personal. It was also stated that medium companies use small ones for projects a lot. This is beneficial to big companies because they can expand to regional markets and work with the same efficiency.

From the point of view of personnel, small companies are very flexible – they are highly involved in working with client as value him a lot. It is also stated that those employees who start in small companies can develop themselves easier as they are highly involved from the start, so, consequently, acquire necessary experience faster.

Small audit companies work not only with small clients, but also mid-size businesses as it can be very beneficial for further relations. Also these auditors prefer clients that relatively big and want to order supplementary services as well or those clients who have higher sales volumes.

Specific of work of Big Four is that they provide only audit report while mid-size and small companies tend to do more – they provide audit report with detailed analysis of mistakes that exist in accounting, make recommendations on how to solve them and short conclusion for top management as well as for shareholders on current state of accounting reports and possible tax risks. This aspect is very important for establishing long-term relations with the client by offering more personalized service.

## 3.2 Data analysis

*Cases*

The preliminary interview is held with one of owners of “Business Consult Audit Ltd”, the company that operates for 12 years on the market, Anna A. Kraevskaya. Anna is a certified auditor and active member of the ACR (Audit Chamber of Russia). Business Consult Audit Ltd. is situated in Nefteyugansk, Khanty-Mansi Autonomous Region. Oil and gas industries and oil service are the main economic sectors in the city and, consequently, the most developed and interesting markets for auditors. The firm has recently joined self-regulated organization Audit Chamber of Russia which is nowadays one of the largest self-regulated audit organization in Russia. Before that, Business Consult Audit operates under ACG with famous groups from Moscow such as CT-Audit and Razvitie Business System (RBS). The case was chosen because of company’s experience and its wide knowledge of industry not only in Syberian region, but also in Moscow and Saint Petersburg.

The other six companies that are used for the research are Fides, GSK Audit, Norman Audit, ZHKS Kron, ACG Dialir and Nobel Audit. The formal criteria for them are the number of auditors with certificate – less than 15 employees (Ministry of Finance, 2016) and not less than 10 years on the market (which means that a company has experience in the area and its strategy is reliable). They are all members of different self-regulated audit organizations and they have experience from 10 to 19 years on the market. Another aspect is income they receive from audit activity. For small companies it is less than 35 million rubles. Due to this, companies were chosen to provide similar results, as they are perceived as ordinary representatives of Russian audit market. These cases assist in analytic generalization – they do not show generalization “from samples to universe” (Yin, 2003) but it is used for creating a theoretical framework that can be utilized for making affirmation regarding similar situations. Table 3 presents companies and their characteristics.

Table 3

Characteristics of interviewees

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| № | Company name | Position of interviewee | Years on the market | Income from audit in 2015, mln rub | Number of auditors on staff |
| 1 | Business Consult Audit | Owner | 12 | 3.8 | 3 |
| 2 | Fides | Senior Auditor | 19 | 2.4 | 4 |
| 3 | GSK Audit | Auditor | 20 | 6.8 | 12 |
| 4 | Norman Audit | Auditor | 15 | 35 | 5 |
| 5 | ZHKS Kron | Senior Auditor | 10 | 4.7 | 4 |
| 6 | ACG Dialir | Auditor | 20 | 12.6 | 15 |
| 7 | Nobel Audit | Head of valuation department | 14 | 5.2 | 3 |

*Analysis of interviews*

In order to start analyzing research propositions based on interviewees’ responses, it is necessary to provide specifics of Russian audit market. It is stated that big companies and SMEs have many differences in terms of operation. Smaller companies are “simpler to manage and more mobile while a big audit firm generally has large awkward departments”. Most of head offices of audit companies are situated in Moscow. In regions these companies tend to work with subcontractors or local offices that were acquired by companies in capital. Head office of a big company collects audit reports performed by subcontractors or offices in regions in order to check quality of work. If there are no mistakes and head office accepts it, the signature and seal of this company are put into audit report. However, this procedure takes a lot of time and is not ideal in terms of control. All reports are sent in electronic form and head office checks it selectively. Whenever a local firm makes a mistake in the report, further cooperation with these firms will be rejected. Disadvantages of such structure are higher number of normative internal acts and regulations, increased time of organizing work on distance (in another region, for example).

Difference between audit companies on markets in regions exists because of difference in demand. In big cities there are more companies that are obliged to use audit (because of formal indicators) and order additional services while in regions audit companies usually serve medium size businesses or they are working as subcontractor of big companies. “The difference is high – to the same extent that differs big cities from smaller ones. Demand in big cities is higher because nowadays criteria for obligatory audit are relatively high (balance and income). In regions there are mostly small and medium enterprises which work for big firms, headquarter of which is situated in capital city. Another advantage is that even though big firms may have subsidiaries in the country, their owners are as well in capital. On the other hand, one third of audit firms operate in Moscow. Because of these aspects, the question of choosing an auditor arises” (A. Kraevskaya). It is important to mention that services of auditors from Moscow are much more expensive comparing with other cities, even with prices in Saint Petersburg.

Regarding foreign companies, it is mentioned that they have no incentives to enter the regional market unless there are clients with foreign capital. If there is no interest of expansion to foreign markets, there is no need in international audit company even if it has world known brand because Russian auditors charge lower prices for the similar quality. This is agreed by representative of Nobel Audit – foreign mid-size companies as well are not interested in entering the market as the price of service they used to have is usually not acceptable by Russian client.

On audit market clients demand qualitative service because they understand that it is a reliable source of information they receive for decision making. The more profound and full the audit service is, the more valuable information client receives for strategic planning. Auditors are also perceived as professionals who can assist in developing ones business and increase its efficiency. This becomes even truer with new changes in legislation – acceptance of international audit standards by Russia, which include detailed comments in audit opinion letter. Most of interviewees told that interpersonal relations play important role in working with client – “audit checking for many companies perceived as invasion to something sacred, that’s why usually auditors are personally known, recommended or known by partners. Consequently, the importance of personal relations is extremely important and there is a group of clients who audited for many years because clients trust auditors. Existing client base and clients “passed from hands to hands” is the way to operate on the market.” Even though there is strong influence of big companies, personal relations are the most important factor of non-monopolization of the market.

During interviews, it was mentioned that some companies from big cities, which were audited by mid-size firms, tend to switch to local small auditors because fees are lower but quality is on similar level. This issue gives a great incentive for small companies to improve its quality and more actively use promotion. All interviewed companies told that they prefer to have small number of auditors but who have high qualification rather than more auditors who are at the beginning of their career.

Literature on audit discusses the advantage of specialization on certain industry in order to get more value. This question was raised during interviews. The issue is contradictory because the experts said that “it is not profitable to concentrate on one industry - for auditors the scale is more important. An auditor can check a company in every industry and company’s specialization doesn’t matter as auditor works with financial information.” However, on the other hand, it depends on industries that prevail in a region. For example, if a company has a big client in construction industry (that can be assumed as an important client), the audit company is considered as expert in auditing construction market and it has a better chance of attracting more construction companies because of already established reputation and treatment as an expert. If there are other construction companies that are willing to work with this auditor, then auditor can decide to specialize on this industry. The specialization means that auditor works with a specific market because he has powerful clients there. In this case, it is necessary to protect auditor’s reputation as once it is spoiled, company will lose its clients in the industry.

If we are talking about audit government tender, specialization also can be a competitive advantage as it potentially increases the number of clients. However, usually the most important factor here is the price. So the company should estimate it’s cost and revise a strategy significantly – “companies that specialize on tenders have many auditors (15-20 employees) of low professional category, and they audit several companies at one time, which makes low prices for a service possible” (Nobel audit). However, it is hard to enter this market niche – even if a client knows a company and helps it to get a tender, it is hard to overcome the price of a company that professionally works with tenders as they make cheap product of lower quality spending less time.

Even though there are many ways how to reduce costs, two issues are important. The reduction of costs should not be associated with decrease of quality – this is the one of main principles of all companies interviewed. In order to reduce costs it is necessary to analyze all cost elements. Based on this analysis, cost policy is accepted (optimization of the staff number due to automation of processes, financial incentives for employees based on intellectual contributions and labor participation, reduction of material costs by saving resources). However, most of interviewees mentioned that governmental support, regulation and control of audit activity are the measures that can help audit market a lot.

Nikiforov (2015) agrees and expands that the development of audit market environment in Russia is possible if several steps will be achieved: legislation change on audit service in terms of increasing requirements for audit organizations and their responsibility for results of work; clarification of criteria for auditors and increase of requirements for auditees for avoiding obligatory audit; creation of conditions for transparency and openness of information of participants and results of obligatory audit; ensure effective self-regulation. “As the result of those procedures, qualitative changes of structure of the market with active involvement of clients and further development of fair competition, quality improvement and efficiency of audit services” (Sergey Nikiforov, Chairman of National Union of Auditors, Expert RA, 2015).

Speaking about automation of service, it allows company firstly to save auditor’s time; secondly, to systematize and store information (achievements, tests, practice, and documentary evidence) in a more efficient way. There is nowadays a lot of software that can be utilized by auditors, starting from very simple spreadsheets to expensive sophisticated tools. All those are aimed to increase efficiency and decrease time of spending on a specific job. The choice depends on money a company can afford to spend on the software. Even though it has many advantages, interviewees said that is basically can be used by big companies which are able to invest a lot of money into automation of a whole process. Another issue that interviewees discussed is that the main part of an audit service is the auditor’s opinion which has to be done without using software.

There are many factors that can lead to losing a client. Pricing policy, low quality services, lack of understanding of client's demands, defense of independent opinions with possible negative consequences for employees of the client who are responsible for maintenance of economic activities of the organization (disqualification of executives). Interviewees identified the following factors that are important to achieve customer loyalty: competence, professional attitude and quality of service. Another important aspect that appears during the crisis is price. Auditors said that it is nowadays usual for clients (even small companies) to negotiate price and reduce it, so price becomes a subject of haggle.

However, loyalty is not required by auditor as the auditor is chosen by the owner of a company, the auditor himself acts exclusively as an independent expert. The choice of the audit company by knowledgeable customer is carried out on the assessment of business reputation of the auditor. For small companies, there is no reputation in terms of ratings, but what is important is interpersonal reputation and experience of working with the exact client. It is good to know that one’s auditor has a good reputation, but when the price issue appears and the target is achieved, reputation is put on back burner.

Another important aspect that was raised during interviews is how price affects market discussion. It is known that there are several forms of unfair competition in audit, such as black audit which means that audited companies get an opinion letter without even being inspected, dumping policy, when company makes a proposal that cannot be overcame by any of its competitors, but the company also signs a contract for additional services. This leads to decreased quality of audit and discredit of professional service providers as industry. However, it is mentioned that “relations of a client and his auditor resemble relations of a person and his psychologist, so it is hard to compete using dumping strategy. The price question is important but if a client trusts his auditor, companies will rarely switch auditor to save twenty or thirty thousand rubles.” Mostly, it was mentioned that price certainly affects the industry, even though its influence is not that high and companies are ready to adapt their strategy to reduce price for a client.

Afterwards, specific questions regarding sources of competitive advantages are thoroughly discussed and interviewees discuss those that affect their performance. One aspect that should be considered is participation in Audit Consulting Group (ACG). Membership in a group helps to make customer more aware of the company and the chance of contacting this organization is higher. Common way of identifying brand’s position is to see published ratings. The information regarding Russian group of audit companies will be provided on Ministry of Finance website, even though it has published only international networks yet. This is due to law that was signed on March 24th, 2016, so it will take time to pass through all formal procedures. Top manager of Invest-Audit Egor Churin assents that “every company is looking to be in professional rating as it is a great success. It is especially important for audit companies because clients sometimes cannot decide on a service provider. The methodology is transparent and simple – a company operates the certain revenue which means that clients trust this company” (Krasilnikova, 2009).

According to experts, consolidation of audit companies is one of the ways for SMEs to survive and develop on the market - if this group is respected and well-known, it can be a decisive factor for a client to choose this service provider. Another issue is that ACG can become an instrument to overcome unfair competition. “It is necessary to avoid unreliable information that is published by a company, increasing status on the market without additional costs” (MKPC Audit, 2016). In 2017, Ministry of Finance started to register ACGs that meet several criteria:

1. Distribute costs and income within members
2. Operate under united ownership, control or operation
3. Have unified quality control system
4. Share operation strategy
5. Use one brand
6. Together use professional resources (common information share systems, methodology, education)

This can guarantee that ACGs are not just formal unions to get higher ranking, but professional organizations that share one goal. Advantages that were described are cost reduction of methodological documents’ creation, joint events’ organization, ability to provide additional services that are provided by partners, knowledge sharing within ACG and assistance of partners to whom a company can trust as quality of their work is proven by group’s standards. The main idea of ACG is that an organization that professionally sells services and works on expanding customer base. Afterwards, if the company becomes successful while risk of expanding the number of auditors in staff is high, it invites other companies to work as subcontractors. The disadvantage of this strategy for partners is that there is no stable income from attracted clients. It is important to note that for small audit companies it is impossible to join an international network because of financial and reputational constraints.

As for other advantages mentioned during the interview, the following features of ACG can help companies to achieve competitive advantage by a unified informational space with diverse experience in various areas of related activities (such as audit, consulting, assessment activity, marketing research, registration and liquidation of companies, organization of external management of those organizations that were subjected to bankruptcy procedure, accounting, service and support of special software, participation in professional communities, regional and industry specific, best practices in projects accomplishing, IT development and so on). So a company that participates in a group can use resources of other companies in order to position itself better and offer supplementary services to client without spending a lot of resources.

Marketing campaign is another very useful tool for attracting new clients on audit market. For this purpose, personalized marketing is used – it is a concept for customers’ segmentation. The two main principles are that clients are different and it is necessary to find stimulus for them. This process leads to demand prediction and offering a personalized proposal. By summarizing data from interviews, the following steps of how to attract clients are identified:

1. Firstly, analysis of different markets is required. Because of difficult economic situation, number of audit companies is decreasing, so there are clients who have lost their auditors because a company left market or clients want to change auditor because of conflict. It is agreed that firstly clients look for recommendations and only then search for information in open sources.
2. Send offers of implementing audit to potential clients
3. Negotiate on price. As mentioned in literature review part (Casterella et al., 2004), the more power a client has in terms of size or importance to auditor, the more influence a company has during price negotiation with auditor. In the case of rather small company, the leading role is taken by client and a company may force auditor to reduce price significantly. This situation was mentioned by most of auditors and that is it possible to decrease the price to a certain extent - “it is necessary to increase cost efficiency by decreasing fixed costs in order to survive and offer client more interesting price.”

Also, other useful techniques were mentioned. One of the ways to promote an audit company is to actively use webinars. If a company starts series of webinars, it will attract new clients and make them interested in the company. Webinars are relevant on audit market because potential clients are seeking for relevant information as legislation changes from time to time and they will trust the company due to knowledge a company shows during presentation, so reputation will be increased. Moreover, participation in other’s webinars can be beneficial – an auditor can ask questions to a speaker in order to learn about new regulations, trends and technologies while promoting himself. The latter may increase auditor’s reputation in professional circles because attendees of such webinars are mainly auditors. Webinars are also used to learn about state of audit in other regions. While it may be hard to reach professionals in different areas of Russia, it is quiet easy to get information from webinars. This is important because each region has its own problems and their recognition leads to understanding of how a company operates. With exactly the same purpose, it is necessary to be active in social media and special forums because nowadays these means of communication are of great importance and they cannot be neglected.

Organization of seminars is another option. Experts organized free or almost free sessions and the effect was positive. Seminars are excellent in reaching direct clients because auditor directly communicates with them and shows knowledge of subject, which improves auditor’s reputation. With rather small investments, it is possible to get interesting results. Firstly, owner of audit company buck up his personnel as they have to prepare presentations. Secondly, the main purpose of this education is to attract people, who will use services in future if a company can distinctly explain a topic. An event can be organized by using word-of-mouth when audience is attracted through partners and acquaintances. As for small auditors, the event is local because it is hard to get crust of those companies that do education professionally.

“Company should always participate in events that are attended by potential customers – take part in professional discussions and present reports. Publications should always be on a topical problems and it is better to write articles not only because an auditor is asked to do so. These actions will increase company’s rating for both clients and journalists” (Polina Krivoruko, PR in audit market, 2009).

Inna Sergeychik, partner of LA`consulting (PR in audit market, 2009) also states that advertising can be free. Professional magazines publish those materials that suits their policy. Auditors can publish their opinions, comments regarding a specific issue and so on. It is worth promoting a company in Internet, answer the questions at the professional portals, to post news and press releases, to moderate special forums.

If an ACG, in which a company participates, establishes itself high in a professional rating, then the company can use it in advertising. For example, the expert stated that “big companies start conversation with client by mentioning its brand name”. The same may be applicable to smaller companies – information regarding a group they are in can be inserted to firm’s website and to emails that auditor sends to potential clients. Anna Kozlova, senior accountant at “Chto Delat Audit” (NP Consult, 2003) states that rating is a part of marketing campaign – an auditor may show the magazine with company’s rating in order to convince client to choose the company.”

When a company successfully implements these procedures, the best advertising will be companies that were audited previously. After every audit implemented, auditor can add this company to his portfolio. Anna Kraevskaya said that a positive outcome of audits is excellent advertising for small companies that leads to professional reputation increase.

Another important issue raised during interviews is that small and medium businesses prefer to use auditors who have already audited their familiar – if the result is satisfactory, this auditor will be in a preferred position towards others. This is due to the fact that clients refer to experience of work with an auditor and professional reviews rather than price and rating. However, if this audit company also has a high rating, it will be more preferable but the rating itself cannot be the decisive factor on the market on which personal relations are so important.

It is also possible to ask for recommendations after audit is implemented. However, not only big companies should be asked, but also smaller ones because in several years this company may grow and a potential client will be affected by their recommendation. Moreover, it is a way of establishing contact, which is precious for auditor and can provide positive relations in future.

For established companies, word of mouth becomes one of critical factors of further marketing development. Clients of audit companies are usually CEO of firms, even though he does not understand totally all aspects of auditing procedures. Consequently, they cannot be sure that a certain auditor possess knowledge and skills required for qualitative audit. In this case, word of mouth is one of criterion to choose, relying on opinions of their colleagues who already use services of an audit company.

Marketing activities of international and Russian companies are similar in terms of strategy. However, as identified by the expert, international companies have more resources, which they can use for marketing efforts, thus, they can create more profound marketing strategy, but the difference is not so crucial. International companies are more effective in some aspects of marketing, such as seminars and article preparations as they can prepare specific materials regarding several jurisdictions in which they operate and share international experience that is more convincing for clients. While Russian companies may concentrate more on direct communication with clients as they are accustomed to deal with local markets and know how to communicate products to them. These differences between companies are smoothed with experience, which helps to learn about local or international market correspondingly.

Audit is a seasonal service that mostly makes profit in period between November and April, that is why it is important to offer client additional services to have stable income during non-audit period. Besides audit, interviewed companies provide many other services such as consulting in accounting and taxation, marketing research, assets valuation, examination of transactions, financial performance analysis, methodological assistance in accounting policy creation or improvement and others. Moreover, if the company participates in ACG, the group will also be able to offer even more services to a client as a range of services is greater.

However, not every service is relevant on Russian market. According to the expert, “transformation or preparation of financial statement in accordance with IFRS is not highly demanded by the market.” For small audit firm, implementation of audit based on IFRS means additional costs to educate personnel, which may not worth it. According to statistics (Finbaza.com, 2016), 80% of the 145 largest companies that are required to report in IFRS in 2014 used services of Big Four. Most of the rest are audited by international ACGs. This statistics proved by responses during interviews that there are very few request for IFRS service and that it is necessary to have separate department for it. “There is no urgent need to make expensive international audit based on International Accounting Standards (IFRS) without specific short-term goals. Previously, many customers did not have a practical need for audit under IFRS; however, the audit report from an international company is mainly a fashion decision and an element of prestige” (Larisa Mazurina, CEO of "Tax Consultant").

Reporting in accordance with IFRS may be of interest to a narrow circle of users, such as foreign investors, various mutual funds, major credit institutions, major insurance companies and other companies that interact with the foreign capital market. “On the Russian market particular relevance of transformation and reporting in accordance with IFRS is not observed. The list of companies which are required to inform users and to publish this kind of financial statements is small and involves such companies as Rosneft, Gazprom, Rosenergo, Russian post, Russian hippodromes, Rosatom, etc.” (A. Kraevkaya).

During interviews, questions about other services, which are also offered by audit companies, are discussed. Strategic business planning hardly will be an important service to emphasize on for a firm in times of crisis, and that is why:

1. Firstly, the business planning for the future - the process is laborious and time-consuming; it involves analysis of many factors of the business entity.

2. Secondly, the result is a concise report which needs to be done and to provide the customer with numerous calculations and graphic materials, plus a detailed step-by-step description of all processes.

3. Thirdly, the biggest risk is the defense of the final figures for the customer's representatives, who have, as a rule, very modest knowledge in this area. Therefore, the payment for such work may be delayed in time.

Understanding the nature of the crisis situation for any company working in service sphere, it is primarily the reduction of solvency of the consumer that affects the industry. So first of all, the crisis affects the client - buyer of service. He begins to opt out of any unrelated costs. But reducing the tax burden through tax optimization is what will represent the keen interest for the client. That is why any consulting of a customer (including tax consulting) of particular actual issues, of course, is more rational in terms of employment of the specialist of audit firm, if the latter has sufficient professional experience. This path to increase income will succeed much faster.

“To the priorities also refer competent customer support in the field of accounting (it may be a permanent subscription services or even accounting with the rights of the chief accountant under contract). Don't forget about good old accounting. It is necessary for all and always. And given the fact that Russian accounting for over last decade is in a state of endless reforms and annually economic households are faced with changes in accounting legislation which, in turn, can have a significant impact on aspects of taxation – this is the direction for the consulting services that remain always relevant” (A. Kraevskaya).

Based on market analysis, income from audit is decreasing while income from other services is increasing and constitutes 50% of total revenue. This is the opportunity that should be used in order to sustain one’s business. By earning additional income, a company can support audit activity by investing in it and be more flexible in fees offered to potential clients. The trend is that consulting and valuation markets, unlike audit, not necessarily react on macroeconomic problems by recession. This is because in crisis clients use consulting services more in order to solve current problems. According to Dionis Vasiliev, Vice-President of consulting group "Neo Centre" (Audit-it, 2014), during economic downturn volume of consulting services increases and during rise of economy demand falls. David Gray (Audit-it, 2014) adds that in current economic situation demand for cost reduction services, operational efficiency provides large opportunity for audit companies.

Another feature of the audit market is that provision of legal support that the expert mentioned during interview is also viewed as an important consideration. Victoria Smirnova, head of Tax Consulting department of ACG MEF Audit (Audit-it, 2016), adds that demand for legal consulting has shifted from litigations to complex support of tax inspections: “representation of taxpayer’s interests in higher instances, preparation of petitions of appeal to higher tax authorities. One of the reasons to this is that the efficiency of case’s consideration by tax authorities”.

Larisa Puzankova, CEO of Vostok-Audit (Ardalianova, 2013) identifies that client should be able to receive every supplementary service he needs for operating on the market; the quality of services is of top priority to clients. “Most popular services are outsourced accounting, tax and financial consulting. The market itself shapes customer’s demand developing primarily those services that are required by the market in a particular period. However, audit company should be aware of the fact that company can create demand for additional services when it offers them. It is necessary to be ahead of market needs by relying on experience and best practices of foreign audit markets.” Larisa Puzankova (Ardalianova, 2013) also mentions that clients are becoming more selective and this trend continues to grow. Therefore, companies need to be prepared to offer not only classical audit but also the whole complex of related services.

## 3.3 Research results

Based on literature review and analysis of interviews, the sources of competitive advantages are identified and three research results are stated as they are considered to be the most relevant for improving competitiveness of small audit firms. In this section literature regarding why these sources are important is discussed and empirical explanation is provided.

**Small audit company can achieve competitive advantage by participating in Russian audit network**

Raue and Wallenberg (2013) state that horizontal cooperation improves performance of service providers involved while Kale et al. (2000) point that cooperation should be based on companies’ similarities in terms of geography, culture or competences. Dawson (2007) agrees that partnering should be considered as a way to achieve competitive advantage.

It is necessary to define what audit network is. According to Ministry of Finance, it is a group of companies that fully informed body accepts that the organizations are interconnected. A group has unified control, strategy and professional resources. It also has a unified brand that companies use in advertising or business communications. This proposition is discussed from two perspectives – how ACG can help a company to achieve competitive advantage and why it is beneficial for bigger audit company. The first question is answered in the following way: a company, which potential clients are not familiar with, by participation in ACG receives awareness and, consequently, its reputation is increasing. This company also gets more contracts for audit because audit checks from other firm participants can be outsourced to this company. As for internal aspects, the company can improve its internal system by exchanging experience with other participants, adapting unified methodology and deploying best practices. Employees’ knowledge can also be improved because of training and knowledge sharing with other firms.

Regarding bigger participants, the cooperation is also beneficial for them. These companies will increase their portfolio by providing additional services to clients in regions. What is more, if number of clients increases, they can be audited by small firms, so the customer base can be increased without increase of required resources.

It is important to mention that for small companies it is only possible to join Russian audit network because of limited resources they possess and that this audit network must be registered by Ministry of Finance of Russia so that quality standards are confirmed.

**Direct marketing and branding activities have positive influence on performance of small audit companies**

DeFond and Zhang (2014) mention that client base is built on reputation and not vice versa. However, potential clients use peer review and information from open sources as a considerable argument for making a choice (Hilary & Lennox, 2005; Swanquist & Whited, 2015). The gap in literature consists in opportunity to work with the opinions of interested parties. The best way to do this is to concentrate attention on marketing activities. Broderick (2010) states that marketing capability is not developed in service providers. Companies usually don’t have enough expertise of marketing campaign implementation and achieving necessary audience. So those companies that involve marketing in their value-creation strategy can benefit a lot.

Advertising is of great importance in audit market because marketing campaign that targets potential customers, increases awareness of a company and provides effective means of communication. Properly organized advertising procedures will increase number of clients, which, in turn, will increase number of audit services performed. If auditing passes without claims and lawsuits, auditor’s reputation is increasing.

In order to specify marketing activities, they are divided into two categories – personalized marketing and branding. Personalized marketing refers to direct connection with client without intermediary by using email or calls. This option is relevant because auditor can offer flexible conditions and better understand customer’s needs. The second way is to use Internet as the option to represent the company. Internet is an excellent place to share professional opinions, present own view on problems existing on Russian audit market or listen to client’s needs. This option works because costs are quiet low while an auditor can show his knowledge and experience, create awareness of colleagues and clients, and build reputation. It is possible to use different instruments such as organization of seminars, webinars, writing articles. Another issue that affects the market a lot are personal relations that can be established during implementation of those procedures.

**Demand for accounting and tax consulting increases during economic recession and specialization on these services can be used as a competitive advantage for small audit firms**

Carrera et al. (2003) state that auditor’s activity consists of two essential parts: audit and consulting. However, in literature, other possible ways to differentiate audit company’s portfolio are not specified (as there are, for example, many variations of consulting that an auditor can implement) and little direction towards how they affect competitiveness is made. The assumption of this proposal is that there is a set of supplementary services, provision of which is as important as audit itself.

Provision of services such as different consulting (tax, legal, financial, etc.), audit based on International Audit Standards (IFRS), managerial accounting, bookkeeping and valuation increases additional income which can be invested into sustaining quality of work. This can also attract audit clients who are interested in additional services and is a way to increase fees for clients who order audit and additional services together (Simunic, 1984).

However, it is important to distinguish current state of economy. During economic recessions, companies are more willing to invest in services that can provide cost reduction or improve their performance in short and medium run perspective. Consequently, demand for tax and accounting consulting increases which provides an opportunity for auditors to concentrate especially on these services as far as the crisis continues. The first increases due to desire of managers to get momentary benefits and not to wait for the effect of the service, which is quiet explainable in the crisis. Another issue identified is that customer support in accounting field increases their importance as every company needs a proper accounting system because of constant process of changes of accounting standards in Russia that affect companies a lot.

## 3.4 Discussion of findings

During the interviews it was discovered that personal relations play one of the most important roles in establishing a competitive company because auditing is referred to be similar to entering private life – that is what differentiate audit market from many others where price is what usually firstly considered by a customer.

However, professional reputation is also important. It was mentioned by the experts that “reputation is something that is very hard to gain and it is established by years of productive and careful work; it is easy to destroy reputation with even one claim from a client because of the same word of mouth.” In this case, implementation of the measures proposed should be carefully analyzed in order not to harm existing reputation.

All three propositions were proven to be viable with several notes. Regarding the first one, participation in audit network is definitely the advantage but it is necessary to mention that there are two types of groups that operate in Russia (it usually unites companies from different regions) – groups that consist of audit companies (in this case, participation is beneficial because of professional reputation of audit services only and knowledge sharing in this specific industry) or groups that consist of companies from different markets such as audit, legal, IT, consulting, etc. (which is beneficial from point of expanding portfolio by providing additional services). In general, involvement in audit network gives advantages for a firm in form of professional reputation improvement, which a company can use to promote itself, and usage of resources of the group, which involves several aspects starting from knowledge sharing between participants and training sessions to improvement of quality because of implementation of policies and procedures that are used in this ACG and getting new orders from other participants. Based on RBV perspective, the participation is valuable as it goes along with company’s strategy, it is in-imitable because every ACG has its own structure with specific set of resources and cannot be fully replicated.

The second proposition is also an important step for enhancing reputation. Marketing activity is divided into two parts – selling marketing and branding. Two of those are equally important but targeting a bit different audience. Selling (or personalized) marketing is usually email or phone conversation with client with purpose of making him directly interested in service. As far as small audit firms don’t have high budget for marketing, this is a way by which companies communicate with client while spending only time they have. Another option is to use seminars. Interviewed companies organize several events and attract clients who were difficult to get by other means of promotion. On the other side, branding is used to communicate more with professionals and build reputation but it is possible to address clients too. Internet activity can be implemented in many forms, such as participation in webinars, preparation of articles, panel discussions and participation in professional audit forums – these activities were also mentioned during interviews as relevant on the market. As a result, these marketing activities lead to better awareness and, consequently, to stronger reputation. Branding is not designed to sell the service but it is about building reputation and relations which in long-term result in increase of customer base. Company should develop both types of marketing activities in order to increase number of contracts nowadays by using direct marketing and to build foundation for future communication with customers by branding activities. RBV approach tells that marketing is a valuable capability as it correlates with the strategy of value-creation; it is in-imitable as marketing activities are connected to reputation while it is different in each company.

Non-audit services are also something that auditors should consider. The trend shows that some services expect higher demand than other. As it is discussed in interview and learned from secondary sources, economic environment is the main driver of the demand. Nowadays the situation increases importance for tax, financial and cost consulting while decreases for IT consulting and strategic planning (Expert RA, 2015). This should be considered when a company decides to emphasize on a service because otherwise time and money are spent on something unattractive to the market. For example, such service as audit according to International Financial Reporting Standards in theory is considered as a competitive advantage. However, in context of Russia, it is not – IFRS’s popularity is decreasing because only small number of companies actually need international standards and other, because of tough financial situation, decide to postpone this decision. Based on interview results, two main services are identified – tax consulting and accounting support. This may be explained by client’s direction to affect company in short-term while reducing significance of long-term investment. According to RBV view, non-audit services are valuable as they create additional value; they are rare as not each company provides these services; it is in-imitable as services’ quality cannot be easily replicated because of personnel knowledge and experience involved.

During discussion of possible differences between Russian and international companies, several differences are found, which do not change the strategy significantly because of the same client’s needs, even though they usually target different companies. The most significant variation is found in network membership – both Russian and international companies have specific advantages. However, as only small companies are considered in the research, the only option is to join Russian audit networks. Marketing approach also can vary due to different experience companies have (global and local perspective). Despite these differences, it is possible to consider both cases suitable for the research framework identified further with several amendments that should be made during strategy formulation.

The interviews with industry expert provide detailed analysis of how can companies compete and what are the trends nowadays. The case design reveals that it is impossible to analyze a company in isolation from market environment that surrounds it because otherwise the result cannot be applicable and useful for companies.

# **Conclusion**

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## Theoretical contribution

Based on proposed competitive advantages and stated research results, theoretical framework of how a small audit company can compete on Russian audit market is identified (Figure 4). The framework includes three main factors which companies use to compete successfully. All of those lead to better performance and, hence, to competitive advantage. What is the more important is that they are interconnected, so it basically means that, for example, marketing strategy is connected to network participation as participation itself can become a part of branding strategy. Provision of additional services can be achieved by participation in a network by acquiring knowledge and using capability of another participating company.

Accounting

Tax consulting

Audit consulting group

Audit network

Branding

Personalized marketing

* Webinar
* Panel discussion
* Professional online forums
* Submission of articles
* Email
* Seminar
* Calls

Figure 4. Theoretical framework of competitive advantages of small audit companies on Russian market

Every element consists of several activities which were identified as important during the interviews and analysis of secondary sources. Because they are connected, their consolidation is synergetic and may provide even more value to a company and simultaneously improve effect of these elements. These activities contribute to improvement of company’s reputation and performance.

This theoretical framework expands previous studies on competitive advantages of audit firms, precisely contributing to research of small companies and providing opportunities for their development.

## Managerial implications

Competition nowadays is gaining more and more importance due to unstable economic situation and decrease of income of audit firms as number of clients has reduced. Also small audit companies are limited with resources, so their strategic moves must be thoroughly analyzed in order to allocate resources properly.

It is important to mention that multiple case analysis is not used to make generalization in statistical meaning – generalization to population – but it is rather used for analytical generalization which means that multiple case study creates a theoretical premise that can be utilized for “situations akin to the one studied” (Wikfeldt, 2016). It means that the theoretical framework built in this paper is applicable to the specific conditions. To start with a company has more than 10 year experience on audit market, its income is less than 35 million rubles and it has less than 15 auditors on staff. Another important aspect is economy condition of audit market – in years 2015 and 2016 the growth rate of audit market was less than inflation increase.

The framework can be used as the guideline of what a company should put emphasis on if the company matches criteria mentioned above. How does each element contribute to overall improvement of company’s performance? If we take the first one – participation in a network – this benefits to knowledge generation by sharing practices of companies that are in a group and implementing the unified quality system. The cooperation is fruitful for each participant because it increases quality level of each company, attracts more clients and increase place of rating generally of the group.

It is known that proper marketing campaign increases number of clients a company has but it is essential for audit firms as marketing is one of the best ways to increase client base. Companies should pay attention to two forms – branding and selling marketing. As reputation is at stake, branding plays great role as it builds awareness of potential clients and professionals. Any form of marketing activity implies that the communication will be established whether directly with client or with professionals in the same or related industries. Both aspects are necessary because when a company is on a good standing with colleagues, the word of mouth effect starts to work and it may attract new clients to this company. While branding is a long-term strategy, direct marketing is also important as it allows to get more services ordered in short-run which improves company’s position and provide additional income that can be spent on improving competitiveness by investing into employees’ training, more efficient software, etc.

Many audit companies try to offer as many non-audit services as possible. However, it is not rational usage of resources because demand is different (Expert RA, 2015). This is due to different needs that are connected to economic conditions in Russia. In existing market conditions, companies should concentrate on provision of rather short-term services such as tax consulting and accounting. These help to efficiently deal with tax burden and decrease mistakes that can lead to fees or incorrect use of financial resources. As well as for marketing, companies get additional income from provision of non-audit services and increase workload during the send part of a year when there is almost no demand for audit.

## Limitations and suggestions for further research

General condition of economy is important as it affects company’s behavior on the market. However, the situation is changing constantly and the results of research may be insufficient in a certain market environment, so further research must be implemented in order to find appropriate strategy for different market conditions and test whether these research findings are applicable in other economic conditions.

The data gathered from case study interviews is subjective because they are based on emotions, judgments and opinions of interviewees. Consequently, it is necessary to provide more cases that should accept the framework elaborated during this research. Provision of additional cases is important because of enhancing validity of research is an issue with which case study struggles.

This paper discusses that companies’ strategic behavior in regions of Russia is the same everywhere but it is necessary to prove this condition by studying competitive advantages that are used by audit firms in different regions through the country.

This research lacks evidence in terms of economic feasibility of the case. So further research should identify economic consequences of implementing all proposed actions. It may appear that some of them, even if they are good and well reasoned in theory, can be inapplicable in practice because of costs associated with implementation. Finally, the framework of competitive advantages that can be used without adverse effects to economical state of companies should be proposed.

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# **Appendix 1. Interview questions**

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| **General questions:** |
| What are the formal criteria by which it is possible to differentiate companies? |
| How important is specialization in a particular sector? |
| What are the reasons for foreign company to enter Russian market? |
| What are the actions that the audit firm may undertake in the period of crisis to stay competitive? |
| For what reasons the company may lose the client? |
| What are the main challenges when a client selects an auditor can be identified? |
| How to achieve customer loyalty? |
| How can a company reduce costs? |
| How often do customers order additional services and what kind of services? |

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| **Context specific questions:** |
| Is there a difference between the audit market in the big cities (Moscow, Saint Petersburg) and medium cities? |
| What is the difference between foreign and Russian companies working on the Russian market? |
| Are there any advantages in the promotion of regional firms from Moscow and St. Petersburg or international firms? |
| What are your future expectations of Russian audit market? |

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| **Questions about sources of competitive advantage:** |
| How can a company automate processes, and does it make sense for small companies to do it? |
| How significant is the advantage given to the company which offers transformation or preparation of IFRS statements? |
| How does the provision of IFRS audit change any aspects of the functioning of the company after the introduction of this service? Is it relevant in the Russian market? |
| To what extent does client’s influence affect company’s behaviour? |
| What are the benefits of participation in audit consulting group? |
| Can the participation in them be an advantage for a companies compared to other small companies that don’t participate in any of those? |
| What marketing activities help to promote the company's services? What are the most important in your opinion? |
| What services should small companies emphasize on? |
| What are the most popular non-audit services during the crisis? |
| Are there any services that will show higher demand in future? If yes, then what does it depend on? |
| Does experience of a company affects client’s choice? |