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Small firm accountants as business advisers: accounting for the differences in their provision of business advisory services in Norway and Scotland

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Abstract

The European business scene is dominated by the SME sector. One important characteristic of smaller SMEs is that they rarely have the resources to conduct accounting duties in-house. Consequently they often seek external assistance from accountants. Because of the ongoing cooperation the small firm accountant has with his/her clients, through the provision of basic accounting services, there is a potential for the development of the trust required to act as a business advisor As such small firm accountants have increasingly depicted themselves as multidisciplinary practices for an extensive array of business advisory services. Previous research indicates that there are substantial variations in the extent to which small firm accountants deliver business advisory services and substantial differences in the range of services they provide. It is these differences, and the reasons underlying them, that constitute the focus of this paper. Employing a resource-based perspective this paper analyses the main determinants of variations in the degree to which small firm accountants deliver business advisory services. These determinants include the strategic intention of the accountancy practice, its internal development focus and its external alliances. The data employed is derived from two recently collected samples of small firm accountancy practices in Norway and Scotland providing an opportunity to contrast the impact of two different statutory regimes.

Introduction

The European business scene is dominated by the SME sector, that is by firms having 250 employers or under. It represents 66% of all jobs and 65% of the total business turnover in the European Union. One important characteristic of the smaller firms in the SME category is that they rarely have the resources to allow accounting duties to be conducted in-house. Consequently small firms often seek external assistance from accountants. For example in Norway about two thirds of firms with fewer than 100 employees use the services of an external accountant in the production of financial accounts (Gooderham et al, 2004).

It has been argued that because of the ongoing cooperation the small firm accountant has with his/her clients through the provision of basic accounting services there is a potential for the development of the trust required to act as a business advisor (Gooderham and Nordhaug, 2000). Indeed we may observe that in a number of countries accountants who have small firms as their client base have been developing services over and above traditional accountancy services. Increasingly small firm accountants are depicting themselves as "multidisciplinary practices, one-stop shops for an extensive array of services, including financial advisory, management consulting, and legal services" (Greenwood, Suddaby and Hinings, 2002: 58). Although it is important not to exaggerate the current size of this market for business advice – few established consultancies regard the small firm business advice market as attractive (Jevnaker, 1996) – it is clear that accountants are becoming a major source of business advice. For example in the UK Kirby and King (1997) and Deakins et al (2001) found that small firm accountants are among the most frequently used external sources of advice.

However, research also indicates that there are substantial variations in the extent to which small firm accountancy practices provide business advisory services and substantial differences in the range of services they provide (Gooderham and Nordhaug, 2000). It is these differences, and the reasons underlying them, that constitute the focus of this paper. A resource based view would suggest that these differences will be related to features of the individual accountancy practices. However, by employing data from two different countries, Norway and Scotland, we are also able to control for the impact of the regulatory environment.

In the first part of this paper we present the most salient features of the Norwegian and Scottish contexts. Thereafter we present and employ the resource-based view in order to develop a number of hypotheses that seek to explain variations in the provision of business advisory services. This is supplemented by a comparative perspective that emphasizes the statutory differences between Norway and Scotland. The hypotheses are tested and the results discussed. Finally, we draw a number of conclusions regarding those resources that appear to be most pertinent for small firm accountancy practices to develop as business advisers as well as some comments on the way in which differences in the statutory environment impact on Norwegian and Scottish small firm accountants.

The Norwegian and Scottish Contexts

In order to meet statutory requirements regulated by Norwegian law, firms are obliged to produce annual financial accounts. Because of their complexity, rather than doing this in-house, two thirds of all small firms in Norway employ the services of an external authorized accountant (*autorisert regnsaksfører)* for this purpose. In Norway all persons that offer accounting services to others have to be authorized in accordance with Norwegian law.

Since 1993 a prerequisite for authorization is a minimum of two years of higher education within economics and business administration, as well as two years of relevant practice. The purpose behind this authorization is to ensure that the work of the accountant is executed in an adequate manner in accordance with prevailing laws and regulations. In other words Norwegian authorized accountants operate within a pronounced regulatory framework.

In all there are approximately 6,000 authorized accountants in Norway serving in excess of 220,000, mostly small, firms. They typically work in practices of five or fewer associates. In all there are some 2,000 practices of which over 90% are members of *Norges Autoriserte Regnskapsføreres forening* (*NARF)* , a professional association for accountants with a small firm focus.

In the UK only those accountants with a recognized audit practice certificate may undertake the audit of registered companies, however anyone may prepare financial accounts. The initial findings of the UK based Collis Report cited in DTI (2003) suggest that in 85% of companies an external accountant prepares the statutory accounts.

In Scotland there are approximately 15,000 members registered with the Institute of Chartered Accountants Scotland (ICAS) which is a stand alone professional institute (separate in all respects from the Institute of Chartered Accountants England and Wales). The members of which work in industry and the public sector as well as in practice. In practice there are 848 firms providing 1051 branches, they in the majority service the 240,000 small firms and 2500 large firms. The information on other accounting bodies was still being collected at time of writing this paper however the numbers are known to be insignificant in relation to ICAS. ICAS being the substantive majority provider of practice services in Scotland. Educational pre-requisites are in the main higher in Scotland than in Norway in that in Scotland ICAS membership is graduate-only.

A Resourced-based View of Small Accountancy Practices as Business Advisors

According to the resource-based view of the firm, a firms' possession of unique, difficult-to-imitate resources such as competencies are a fundamental determinant of sustainable competitive advantage (Penrose, 1959; Rumelt, 1984; Wernerfelt, 1984; Barney, 1986). Prahalad and Hamel (1990) extended this perspective by arguing that among these resources it is a firm's core competencies that are the critical antecedents to those core products and services that give rise to long-term competitive advantage. Although core competencies are problematic to observe in any precise way they are associated with consistent strategic intent, that is an ambition to set new targets that imply "a sizable stretch for an organization" (Hamel and Prahalad, 1989: 67). But strategic intent is more than unfettered ambition: it also encompasses an active management process that provides a consistent impetus in regard to internal development efforts on the one hand and learning from external alliances on the other.

We argue that the core competencies necessary for the provision of a range of business advisory services are different to those necessary for standard accounting services. Further, we argue that they are derived from three main accountancy practice-specific developments; the possession of some degree of strategic intent that involves seeking new markets through developing new services; the internal development of the practice in terms of the configuration of its human capital; and the formation of external alliances in the development of advisory services.

Strategic intent

The publication of Porter's (1980) book, *Competitive Strategy* placed the emphasis for competitive advantage on external, industry-based competitive issues. One important aspect of strategy according to Porter is that of positioning the firm. In short: "Some positions are more profitable than others...” (Porter, 1990). Applied to small firm accountancy practices Porter’s strategy frame would imply that those practices that position themselves so that they provide standard accountancy practices to larger small firms have customers who, by virtue of their scale, are relatively disposed to buying different types of specialized business services. In other words by achieving this positioning a small firm accountancy practice is able to diversify into business advisory services.

With the diffusion of the resource based view of the firm during the 1980s emphasis shifted to resources and, more specifically, to core competencies as antecedents for diversifying firms. However, core competencies are not developed at random. They are the products of strategic intent, i.e. some form of animating dream that implies a significant stretch for the organization (Hamel and Prahalad, 1994), or “an extreme misfit between resources and ambitions... (that) challenges the organization to close the gap by systematically building new advantages” (Hamel and Prahalad, 1989:67). In some respects its absence is easier to specify than its presence. Firms lacking in strategic intention are firms that have no intention of seeking out new markets on the basis of developing new services.

Hypothesis 1: Those accountancy practices which have no intention of seeking out new markets through launching new services will provide a significantly more limited range of business advisory services than other practices.

However, insightful as the concept of strategic intent is, we see no reason to abandon the insights regarding positioning contained in Porter’s approach to strategy. Thus we will also hypothesize that:

Hypothesis 2: Those accountancy practices with a high proportion of client firms with at least 21 employees will provide a significantly greater range of business advisory services than other practices.

Internal development of human capital

Because of uniform statutory requirements for authorization across national accountancy industries differences in terms of the competencies required for services beyond standard accountancy services must in part be sought by examining the development and accumulation of those types of human capital that create a potential for service diversification. We would argue that there are four main sources of human capital relevant for business advisory services. The one derives from the proportion of the practice's partners that has a degree-level of higher education; the second from the degree to which the practice's human capital is nurtured and developed through a personnel policy and a human resource development plan; the third from the proportion that has a professional training other than accountancy; the fourth from the size of the practice with greater numbers of partners creating more latitude for the development of specialized services over and above standard accountancy services.

Hypothesis 3: Those accountancy practices with a high proportion of degree-level educated partners will provide a significantly greater range of business advisory services than other practices.

Hypothesis 4a: Those accountancy practices with a personnel policy will provide a significantly greater range of business advisory services than other practices.

Hypothesis 4b: Those accountancy practices with a human resource plan will provide a significantly greater range of business advisory services than other practices.

Hypothesis 5: The greater the proportion of non-accountancy professionals the greater the range of business advisory services that will be provided.

Hypothesis 6: The greater the number of partners in the practice the greater the range of business advisory services will be provided.

External alliances

Given the size of small firm accountancy practices, there is clearly a limit to the number of competencies small accountancy practices are able to develop internally. Like any small firm the quality of its external network will therefore be critical for obtaining those resources it lacks. This means that small firm accountancy practices that seek to develop services over and above standard accountancy services are highly dependent on being able to leverage off the competencies of third parties (Birley and Westhead, 1992; Storey, 1994). There are many potential sources of external partnerships or alliances for the development of business advisory services such as lawyers, external auditors, consultants, software suppliers, IT firms, banks and insurance companies. Small firm accountancy practices that develop extensive alliances for the purpose of developing business advisory with many such external actors will have a resource base that enables them to offer a significantly broader range of services than those practices that lack such alliances.

Hypothesis 7: The greater the number of different types of external actors an accountancy practice cooperates with in the development of business advisory services, the greater the range of these services it will provide.

The range of business advisory services and revenue

Given that an accountancy practice has developed the necessary competencies to offer a broad range of business advisory services these will be used as important sources of revenue. This is because small firms are generally willing to pay more for business advisory services than standard accountancy services (Gooderham and Nordhaug, 2000).

Hypothesis 8: The greater the range of business advisory services an accountancy practice provides, the greater the proportion of its revenue that is derived from business advisory services.

An Institutional Perspective of Small Accountancy Practices as Business Advisors

While the resource based view suggests that accountants' capacity to offer business advisory services is first and foremost a consequence of practice-specific competencies, an important supplementary perspective is that the impetus is in part ascribable to the statutory environment in which they operate.

Greene, Kirby and Najak's study (1998) indicates that small business owner-managers see little need for external support and advice. When they do seek advice this is because the advice is viewed as necessary in meeting requirements set by the law rather than because it adds value to the business. On the other hand accountancy practices will respond to perceived opportunities embedded in the environment. In Scotland ICAS (2003a) states that:

> "In the current business environment, businesses have been seeking, and practicing accountants have been providing, more proactive and commercial assistance, and other types of assurance services have replaced the traditional reliance on statutory audit. Whereas most companies in the past only visited their accountants to obtain the audit, much closer relationships are now the norm".

No similar clear-cut perception of the value of moving from traditional accounting services to other types of services is discernible for Norway. Therefore:

H9a Scottish accountancy practices provide a significantly greater range of business advisory services than Scottish practices.

As a consequence:

H9b Scottish accountancy practices derive a significantly greater proportion of their revenue from providing business advisory services than Scottish practices.

Data

Both the Norwegian and the Scottish data sets are derived from identical questionnaires that were developed in conjunction with both Norwegian and Scottish accountants. A draft Norwegian version was translated into English and then retranslated back into Norwegian. The Norwegian version of the questionnaire was mailed electronically to heads of the 1,380 authorized accountancy practices for which NARF has e-mail addresses on November 5th, 2003 with November 17th as the deadline for replies. This sample constitutes about 70% of the total population of authorized accountancy practices in Norway. In all it transpired that 130 of these addresses were defunct. Of the 1,250 practices who received the questionnaire, 257 replied (20%).

The Scottish version of the questionnaire has so far been posted to 213 small practice accounting firms, approximately one third of the total small practice population. In all it transpired that 12 were duplicates (offices) and 6 were marked addressee gone away. Of the 195 practices who received the questionnaire, 47 replied (24%).

Results

In Table 1 we provide an overview of the distribution of advisory services billed to clients by the accountancy practices in our sample on at least four occasions over the last two years.

Table 1. The percentage distribution of advisory services billed for on at least four occasions over the last two years.

Type of advisory service	Norway	Scotland	Total
Taxation/tax planning	76	82	77
Inheritance issues/generation transfer	27	39	29
Choice of type of company entity	77	61	75 *
Debt administration/closure of firms	41	11	37 ***
Financial management/budgeting	88	61	84 ***
Pension schemes	8	11	9
Transference of ownership	45	41	44
Marketing/sales/strategic planning	16	18	16
Secretary to company boards	58	27	54 ***
Administrative routines/IT	50	64	52
Management/organisation/HRM	23	20	23
Training and skills development	23	25	23
Outsourcing of the financial officer function	41	25	38
Remuneration schemes/salary administration	90	57	85 ***
Valuation of firms/mergers/demergers	26	34	28
N	251	44	295

* $p<0.05$ *** $p<0.001$ (two-sided Chi-square tests for cross-national differences)

Overall, Norwegian and Scottish firms tend to offer the same type of advisory services. There are however a few notable differences. Norwegian practices are to a significant extent more likely to offer services in regard to Choice of company entity, Debt administration/closure of firms, Financial management/budgeting and acting as Secretary to company boards.

Table 1 indicates that small firm accountancy practices in general regularly supply a number of advisory services. However, as table 2 shows the range of services provided varies considerably from practice to practice.

Table 2. The percentage distribution of accountancy practices according to the number of advisory services provided

Number of services	Norway	Scotland	Total
0-4 services	24	41	27
5-9 services	55	45	54
10-15 services	21	14	20
Total	100	100	100
N	254	44	298

Chi-square =5.7 (df=2) p=0.058

Table 2 indicates that only 20% billed their clients for ten or more different advisory services over the last two years. The table also suggests that Norwegian small firm accountancy practices tend to provide a broader range of business advisory services than their Scottish counterparts thereby providing some initial support for hypothesis 9a.

In Table 3 we focus on the proportion of revenue derived from the various advisory services. Only a small fraction of the practices derives more than 25% of their gross revenues from advisory services. We will therefore distinguish between those with less than 10% and those with more. The table indicates that few services make a significant contribution to the overall revenues of the practices. Table 3 suggests that Norwegian practices obtain a substantial proportion of their revenues from Remuneration schemes/salary administration while Scottish practices on the other hand earn substantial revenues from Taxation/tax planning .

Table 3. Proportion of practices deriving at least 10% of gross revenues from advisory services, by country and type of service.

Type of advisory service	Norway	Scotland	Total
Taxation/tax planning	21	57	26***
Inheritance issues/generation transfer	3	2	3
Choice of type of company entity	3	2	3
Debt administration/closure of firms	3	2	3
Financial management/budgeting	21	18	21
Pension schemes	0	2	1
Transference of ownership	2	2	2
Marketing/sales/strategic planning	1	2	1
Secretary to company boards	9	0	7*
Administrative routines/IT	7	9	8
Management/organisation/HRM	2	9	3*
Training and skills development	3	2	3
Outsourcing of the financial officer function	15	5	13
Remuneration schemes/salary administration	37	11	33***
Valuation of firms/mergers/demergers	1	5	2
N	251	44	295

* p<0.05 *** p<0.001 (two-sided Chi-square tests for cross-national differences)

Our final table, Table 4, is a two-stage regression analysis of the joint Norwegian and Scottish data sets that enables us to test all of our hypotheses. At stage one we examine the impact of a number of factors on the range of billed-for services provided by small firm accountancy practices. We obtained the dependent variable for stage one by counting the number of services provided by each firm. This variable ranges from 0 (zero) to fifteen, with a mean of 6.7 (median 7) and a standard deviation at 3.3. Seven firms do not provide any services at all, whereas three (1%) provide all types of services indicated in the questionnaire.

At stage two the same analysis is repeated on the proportion of overall revenue derived from advisory services, but with range of billed-for services functioning as an independent variable. Because only a small fraction of the firms derive more than 25% of their revenues from any of the indicated services, we only distinguish between those above and below 10%. The dependent variable for stage two we consequently obtained by sorting the firms into two groups: those with *at least 10%* of their turnover from *at least one type of service* (58% of sample), and those with no single service exceeding 10% of gross income

(42%). This binary variable we then used in a hierarchical logistic regression analysis. At both stages we control for the effect of country.

Table 4. Determinants of i) the range of billed-for advisory services and ii) the proportion of overall revenue derived from advisory services.

	(i) Number of services		(ii) Proportion of revenue from advisory services (logistic)	
			Model 1	Model 2
Variable (hypothesis)	b	beta	b	b
Will not seek out new markets or launch new services unless being forced to (1)	-0,32	-0,12*	0,07	0,12
Percentage of revenue from clients with 21-50 employees (2)	0,03	0,11*	0,00	-0,01
Percentage of staff with a first degree (3)	0,02	0,16**	0,00	0,00
Practice has formulated for itself				
…a personnel policy[a] (4a)	1,34	0,20***	0,36	0,10
…a skills development plan[a] (4b)	0,72	0,11*	0,78**	0,70*
Percentage of staff with an accounting qualification (5)	-0,02	-0,17**	0,00	0,01
Number of staff in practice (6)	0,33	0,20**	-0,05	-0,12
Cooperation with complimentary service providers (additive index) (7)	1,11	0,22***	0,48*	0,31
Number of services (8)				0,19***
Scotland[a] (9a and 9b)	-1,06	-0,12*	0,74	0,92*
R^2		0,39	0,08[c]	0,13[c]
Correctly classified (original sample)			68	70

[a]Dummy variables [c]Cox & Snell pseudo R^2
b=undstandardized coefficients, beta=standardized coefficients
* p<0.05 **p<0.01 *** p<0.001 (one-sided tests)
N=245

The results in section (i) of Table 4 addresses variations in the range of services offered by accountancy practices. Its findings support hypotheses 1-7 but not 9a. As can be seen from the sign on the coefficient, the less ambitious the firm is with regard to developing products or markets, the fewer services the firm has actually billed for during the last years. Most of the firms have very few clients with more than 20 employees, on average 5% of revenues derive from this type of client. We note that the larger the percentage of relatively large clients, the greater the range of advisory services. As can be seen from the coefficients for dummy variables representing personnel policy and skills development plans, practices having formal plans in this area will also offer more services. Firms with both types will on average offer two more services than those that have neither personnel policy nor skills development plans (controlling for all other variables in the table). We further note that the larger the proportion of staff qualified in accounting, the *smaller* the number of advisory services offered. Personnel qualified in accounting apparently tend to focus on core accounting services, rather than on related advisory services. We also controlled for size, as measured by number of staff, and we find that the larger practices tend to offer more services. On average, one additional service requires three additional staff members (all other things being equal). In order to capture the impact of business alliances, we designed an additive index of the extent of cooperation with other types of service providers: lawyers, external auditors, consultants, software suppliers, IT firms, banks and insurance companies. The results indicate that the greater the extent of external cooperation, the greater the range of services offered. Finally we note that Scottish firms on average offers about one service less than Norwegian firms. The model as whole explains close to 40% of the variation in the number of services, which is relatively high for this type of data.

Section (ii) of Table 4 addresses variations in the proportion of revenue small firm accountancy practices derive from advisory services. While it attempts to test hypotheses 8 (the number of services) and 9b (country) we considered it prudent to control for possible effects deriving from the other independent variables employed in section (i). In line with hypothesis 8 we note that the larger the range of services offered, the greater the probability that *at least one* of these services will constitute a substantial proportion of turnover (as operationalized by the 10% threshold). This indicates that practices with a relatively large portfolio of services tend to derive a greater proportion of their revenue from advisory services. Hypothesis 9b assumed that Scottish practices would tend to derive more of their revenue from advisory services than their Norwegian counterparts. Table 4 shows that this is the case meaning that although Scottish practices tend have a relatively narrow range of services these are of greater significance in revenue terms than the broader range of services are for Norwegian practices.

Of the control variables we included only *Practice has formulated for itself a skills development plan* has any significant impact.

Conclusions

Drawing mainly on resource-based theory this paper has succeeded in a number of respects in regard to accounting for differences in the provision of business advisory services by small firm accountancy practices. Strategic intent, the internal development of human capital and external alliances clearly all play important roles in determining the breadth of services provided. In addition we have noted that positioning the practice in relation to serving larger small firms also has some effect, although it is rather limited.

Furthermore, this paper has demonstrated that on the whole the range of services a small firm accountant provides has a significant impact on the proportion of revenue derived from advisory services.

However, the paper also indicates that Scottish practices while tending to offer fewer advisory services actually derive a greater proportion of their revenue from these than their Norwegian counterparts. Table 3 suggests that this may be due to the significance of services related to Taxation/tax planning which in turn indicates how the different statutory regimes create different opportunities for Scottish and Norwegian small firm accountancy practices.

ICAS (2003b) states that for Scotland the "profession will be increasingly involved in reporting on non-financial matters…Company audit exemption, technology and the drive for value for money will mean that traditional services such as audit, accounting and tax become less profitable for smaller practising firms. This is likely to result in a polarisation of firms as some focus on higher value services and others focus on low cost, high volume work. There are likely to be fewer sole practitioners and smaller firms, as many firms merge to gain critical mass and provide the breadth of services needed by clients." The question is whether the profession in Norway will eventually follow suit.

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