

CHANGE IN THE INDIAN ACCOUNTING PROFESSION: THREE STUDIES RELATED  
TO THE ENTRY OF THE BIG FOUR ACCOUNTING FIRMS IN INDIA

by

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## **ABSTRACT**

This dissertation focuses on the globalization of audit markets. In particular, this dissertation is studying the entry of the Big Four accounting firms into India post-economic and political reforms of the early 1990s. The dissertation is comprised of three separate, but related studies. Each study appeals to prior research in accounting and related disciplines to examine the entry of the Big Four accounting firms in India. The first study appeals to audit market and economic research on incumbent pricing to examine ways in which local accounting firms in India adapted to the competition introduced by the Big Four accounting firms. The second study is an account of the change in the organizational field of the Indian accounting profession caused by the entry of the multinational accounting firms from 1990 to 2005 from a social constructionist perspective using the model of nonisomorphic change. The third study examines the change in the Indian accounting profession from 1990 to 2005 caused by the entry of the Big Four accounting firms in India from a critical perspective. It appeals to the theories of globalization to examine the change. Taken together, these studies attempt to provide the Big Four accounting firms useful information about the pricing strategies likely to be faced by them from local accounting firms in a new market, provide insights into the multiple roles played by professional associations in the process of radical change in the organizational field, and emphasize that globalization of accounting markets has not been accompanied by a level playing field for the local accounting profession in the globalized markets.

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## **CHAPTER ONE: GENERAL INTRODUCTION**

This dissertation focuses on the globalization of audit markets. In particular, this dissertation is studying the entry of the Big Four accounting firms into India post-economic and political reforms of the early 1990s. The dissertation is comprised of three separate, but related studies. Each study appeals to prior research in accounting and related disciplines to examine the entry of the Big Four accounting firms in India. Each study is discussed separately in the following three sub-sections.

### **Study One: Incumbent Pricing Response: Evidence of the entry of the Big Four accounting firms in India**

The first study appeals to audit market and economic research on incumbent pricing to examine ways in which local accounting firms in India adapted to the competition introduced by the Big Four accounting firms. Using data from the annual reports of Indian companies from 1995 to 2005, the study examines whether factors such as the age of the accounting firm, market structure, and the tenure of the auditor are associated with incumbent accounting firms' pricing response to the entry of the Big Four accounting firms. Results may suggest newer incumbents will cut prices more than older incumbents, medium sized incumbents cut prices more than small sized incumbents, while incumbents with longer tenure cut prices less following entry.

### **Study Two: Impacts of Globalization: Evidence from the Indian accounting profession**

The third study examines the change in the Indian accounting profession from 1990 to 2005 caused by the entry of the Big Four accounting firms in India from a critical perspective. It appeals to the theories of globalization to examine the change. The study attempts to enforce the view that globalization is not a natural and inevitable process, but that it is a politically



constructed institution that is driven by powerful international bodies such as multinational accounting firms and the International Monetary Fund, using instruments of coercion and pressure. Specifically, I intend to explore the interconnectedness of professional and state politics with global forces by examining the role played by professional associations and the state in the process of globalization. The results will show how the multinational accounting firms, well positioned in the international economic system, are capable of not only changing the boundaries of the local accounting profession, but also becoming competitive forces in a relatively short span of time from 1990 to 2005.

**Study Three:  
Entry of the Big Four accounting firms in India: An Institutional Perspective**

The second study is an account of the change in the organizational field of the Indian accounting profession caused by the entry of the multinational accounting firms from 1990 to 2005 from a social constructionist perspective using the model of nonisomorphic change. The change was precipitated by the foreign exchange crisis that almost turned the country bankrupt in 1991. To deal with the shortage of foreign exchange reserves leading to non payment of external debt, the government of India requested a Stand-By Arrangement from the International Monetary Fund in August 1991. One of the stipulations of the Stand-By Arrangement was that the multinational accounting firms, essentially the Big Four accounting firms, be allowed to provide consulting services in India. Results may reveal that professional associations are not only concerned with preserving the existing prescriptions but also play an important role in legitimating the change through a process of discourse in the field. This discourse enables the change to be resisted, debated, and eventually accepted.

## **Overall Contribution**

Taken together, these studies attempt to achieve the following broad objectives:

1. Provide the Big Four accounting firms useful information about the pricing strategies likely to be faced by them from local accounting firms in a new market.
2. Determine the effect of the entry of the Big Four accounting firms in a new market on the price structure of audit services in the audit market.
3. Provide insights into the multiple roles played by professional associations in the process of radical change in the organizational field.
4. Reinforce the theory of institutional globalization, which states that transnational institutional forces work proactively to create global markets to the detriment of the weak nation states.
5. Emphasize that globalization of accounting markets has not been accompanied by a level playing field for the local accounting profession in the globalized markets.

The remainder of this dissertation presents each of the three studies in detail.

## **CHAPTER TWO: STUDY ONE: INCUMBENT PRICING RESPONSES: EVIDENCE OF THE ENTRY OF THE BIG FOUR ACCOUNTING FIRMS IN INDIA**

### **Introduction**

The purpose of this study is to examine the effect of the entry of the Big Four accounting firms on the audit fees charged by the local accounting firms in India. The entry of new firms has important effects on incumbent firms and consumers. New entrants increase competition, reducing market share and profits of incumbent firms. It is obvious, therefore, that incumbents have strong incentives to deter entry, while entry is beneficial to consumers as new firms also introduce new products and processes, forcing incumbents to become more efficient and innovative (Geroski, 1995). In the event of entry, incumbents have to decide on the most effective response. They may reduce prices before or after entry to deter potential entrants or simply to maximize current profits in the face of increased competition (Simon, 2005). Alternatively, they may leave prices unchanged and use other strategies to prevent entry such as increasing advertising expenditures (Cubbin and Domberger, 1988) or R&D and patent protection (Smiley, 1988). Specifically, this study uses audit fees and other relevant data to examine the incumbent accounting firms'<sup>1</sup> pricing responses to the increasing presence of the Big Four accounting firms in the Indian audit market.

This study is interesting for several reasons. First, extant research in the audit literature has little to offer on the pricing responses of incumbents to the entry of Big Four accounting firms in any market, mainly because in the western countries such as USA, UK, or Australia, the Big Four accounting firms are the oldest firms in the market. India is a unique market to study

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<sup>1</sup> Incumbent firms in this setting are the local accounting firms and therefore the terms are used interchangeably throughout the paper

because, before 1995, the presence of the Big Four accounting firms in India was negligible (The New Indian Express, 2002. The Chartered Accountants Action Committee For Level Playing Field (CAAC) published a White Paper regarding the influence of multinational accounting firms in India, especially the Big Four accounting firms and the response of the Indian accounting profession. Prior to 1949, accounting was controlled and regulated by the Government, which eventually vested the regulatory power in the Institute of Chartered Accountants of India through an enactment in the parliament in 1949. Since that time, the Indian economy was comprised of small and medium sized companies and the accounting profession was consequently also dominated by small and medium sized firms. The market for audit services, therefore, was very local and competitive, due to the absence of any one large firm dominating the market. The number of medium sized firms (No of partners >10) was only 52 out of the total of 42,339 firms operating in the Indian audit market in the year ended 2001(CAAC, 2002). Local accounting firms did not face competition from multinational accounting firms and were not required to adopt strategies to maintain their dominance over the practice of accountancy. Since 1995, the market shares of the Big Four accounting firms have increased substantially (CAAC, 2002). In 2004, the Big Four accounting firms accounted for about 62 % of the audit fees in the Indian audit market (Prime Academy, 2006)<sup>2</sup>. Therefore, interest exists in examining the response of the local accounting firms to the increasing presence of the Big Four accounting firms in the Indian audit market.

Second, theories of entry deterrence and incumbent response to entry have generated a variety of predictions. Early limit pricing studies predicted that incumbents would reduce prices before entry, but not change prices after entry (Bain 1956, 1976; Modigliani, 1958; Sylos-Labini,

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<sup>2</sup> It should be noted that Prime Academy derived this market share from publicly available data of about 1394 listed Indian companies as of March 31, 2004.

1962). However, game-theoretic studies predicted that incumbents may reduce prices as a way to drive out entrants and deter future entrants (Milgrom and Roberts, 1982a). These theoretical studies prompted empirical research regarding incumbent responses to entry, producing inconsistent results. Some studies find that entry has a negative effect on incumbent prices (Frank and Salkever, 1997); others find that entry has no effect on incumbent pricing (Yamawacki, 2002). There is little explanation for these inconsistent findings in the entry literature. The present study seeks to address these inconsistencies by analyzing the factors which might influence incumbents' pricing responses and providing useful insights into the pricing strategies used by accounting firms in the face of competition from new entrants.

Simon (2005) was the first study to offer an explanation for why some firms respond to entry more aggressively than others by examining incumbent pricing response in the magazine market. He suggested that incumbents vary in their incentive to respond to entry and those incumbents with greater incentives to respond are more likely to respond aggressively. The results indicated that incumbent and market characteristics moderate the incumbents' incentive to respond to entry; newer incumbents cut prices more than older incumbents, while incumbents that compete in fewer and in more competitive markets cut prices less following entry. However, as Simon himself points out, the results in his study could have been biased due to the high rate of entry in the magazine industry and therefore calls for similar studies in other industries with lower entry rates. The audit market in India had a very low entry rate due to the competitive nature of the market prior to the entry of the Big Four accounting firms and also due to entry barriers imposed by legislation (CAAC, 2002). In this paper, I intend to test the predictions of the entry pricing literature in the Indian audit market by studying the pricing response of the local accounting firms in India to the entry of the Big Four accounting firms.

Finally, Geroski (1995) in his survey of the empirical work on entry, points out that the “short-run effects of entry are likely to be much less than the long-run effects” (pp.436). The reason is that it takes the new entrants a period of five or ten years to reach a competitive par with incumbents. Most of the empirical work he points out has been directed at measuring short-run rather than long-run effects associated with entry, and, as a result, it is not surprising that the entry literature has yielded such inconsistent results. I intend to address this issue by studying the response of the local accounting firms in India for a period of ten years starting from the year of entry (1996-2005).

While this study examines only the pricing responses of the local accounting firms to the entry of the Big Four accounting firms in the Indian audit market, it should be stressed that incumbent accounting firms can adopt alternative non-pricing responses to the threat of entry (Geroski, 1995). This study examines pricing behavior because theory offers testable predictions regarding heterogeneous pricing responses by incumbents and because, prices are observable and measurable, while many non-price responses are unobserved or difficult to measure such as increased scope of services or cost cutting measures adopted by firms (Simon, 2005).

This study has important implications for the Big Four accounting firms as it will provide them with useful information about the pricing strategies likely to be faced by them from local accounting firms in a new market. Local accounting firms in emerging markets can also gain useful insights about the pricing strategies adopted by the Big Four accounting firms when they enter a market. For instance, they may be able to learn whether the Big Four accounting firms offer substantial discounts when they enter a market or whether they maintain the premiums charged by them in the established markets. This study may also throw light on the effect of the entry of the Big Four accounting firms in an emerging economy on the price structure of audit

services in the audit market. For instance, the entry of the Big Four accounting firms might inflate the audit fee structure prevalent in an existing market or might lead to reduced audit fees due to increased competition.

The remainder of the paper is structured as follows. The next section provides a brief background of the Indian accounting profession and the entry of the Big Four firms in the Indian market. Further, it describes the entry pricing literature and incumbent pricing expectations in an audit setting. Section III presents the hypothesis and research design, followed by a description of the sample and the regression models used to test the hypothesis in Section IV. Section V discusses the results and the final section summarizes the study and its principal conclusions.

## **Background**

### *Indian Accounting Profession and Entry of the Big Four accounting firms in India*

In India, prior to 1949, the profession of accountancy was controlled and regulated by the government, which subsequently vested the regulatory power in the ICAI through an enactment in the parliament in 1949. The enactment was, The Chartered Accountant Act of 1949, for the regulation of the profession of accounting in India. This act established a regulatory body for the Indian accounting profession in the form of the ICAI. The ICAI is responsible for conducting examinations, development of uniform standards of practice and the strategic development of the profession. It is also responsible for licensing, certification, training, and discipline (CAAC, 2002).

The ICAI has its headquarters at New Delhi with five regional offices at Mumbai, Chennai, Kanpur, Kolkata, New Delhi and 98 branches spread all over the country. In addition, it has also set up 11 chapters outside India. The total membership of the ICAI is about 115,000 and over 250,000 students are pursuing the Chartered Accountancy course. Out of the total members,

nearly 70% are in practice (www.icaai.org). The Indian accounting profession is mainly comprised of small and medium sized firms, the number of firms with five or more partners being only about 375 in 2001 out of a total of 42,339 firms. The table below gives the distribution of firms by size in 2001 (CAAC, 2002).

**Table 1. Size distribution of CA firms as at 01/04/2001**

<b>No of Partners</b>	<b>No of Firms</b>
2	7161
3	2104
4	796
5	375
6	305
7	206
8	101
9	61
10	34
>10	52

The Big Four accounting firms entered the Indian market in the backdrop of the reform measures initiated by the Indian government due to the foreign exchange crisis in 1991. However, they could not provide statutory audit services due to provisions in the Indian Companies Act of 1956, which only allowed local accounting firms to conduct statutory audits. Therefore, the Big Four accounting firms entered into an arrangement with a few large Indian accounting firms, turning them into “surrogate firms” (CAAC, 2002:34). Each of the Big Four accounting firms



has more than one surrogate firm. Most of the surrogate firms are well established large Indian accounting firms in the traditional areas of audit and assurance services (www. icai.org). The list of the surrogate accounting firms of the Big Four accounting firms and dates of mergers are provided in the table below.<sup>3</sup>

**Table 2. List of Surrogate Accounting firms**

<b>Multinational Accounting Firm</b>	<b>Year of Merger</b>	<b>Surrogate Indian Accounting Firm</b>
KPMG	1995	Bharat S Raut & Co
Ernst & Young	1995	S R Batliboi & Co
Deloitte & Touche	1995	P C Hansotia & Co; Fraser & Ross; C C Choksi & Co
	1999	S B Billimoria
	2004	A F Ferguson & Co
Pricewaterhouse Coopers	1990	Pricewaterhouse; Lovelock & Lewis

### *Entry Pricing Literature*

Limit pricing models emphasize deterring entry before it occurs: an incumbent firm setting its pre-entry price low enough to make entry appear unprofitable. Implicit in the limit pricing models is the belief that potential entrants use current industry profits as an indicator of future profits (Masson and Shanahan, 1982). Such a strategy makes sense for incumbents if the pre-entry profits foregone are less than the additional profits earned by deterring entry and

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<sup>3</sup> For the purpose of this study, the surrogate firms will be treated as Big Four firms from the year of their merger with the Big Four accounting firms.

subsequently raising prices back to monopoly levels (Geroski, 1995). Early theoretical research, notably by Bain (1956), Modigliani (1958), and Sylos-Labini (1962) advocated limit pricing as an effective strategy for deterring entry. However, empirical evidence provides little support for limit pricing strategies. Smiley (1988) conducted a survey of U.S. firms and Singh et al. (1997) conducted a survey of U.K. firms. Both studies found that firms rarely use prices to deter entry. Dynamic limit pricing models, which emphasize that incumbents use their prices to monitor entry behavior continuously, also find little support empirically (Simon, 2005).

Game-theoretic models suggest that rational potential entrants will not be affected by low pre-entry prices, and thus incumbents only squander profits by limit pricing (Milgrom and Roberts, 1982a). These models emphasize the need for incumbents to credibly commit to low post-entry prices in order to deter entry. Another game-theoretic approach uses asymmetric information to make low prices a credible threat. Kreps and Wilson (1982) and Milgrom and Roberts (1982b) found that when the entrant is not sure about the incumbent's pay-offs, the incumbent might have an incentive to cut prices after entry as a way to build a reputation for fighting entry.

Several papers have studied incumbent pricing responses to entry, yielding inconsistent results. In the airline industry, Joskow, Werden, and Johnson (1994) find that incumbents cut prices following entry, while Windle and Dresner (1995) report that entry by low-cost carriers induces price cuts from incumbents. However, Thomas (1999) finds that incumbents in the ready-to-eat breakfast cereal industry do not cut prices after entry. Frank and Salkever (1997) find that brand-name prescription drug prices increase after generic entry, but generic prices fall with generic entry. Yamawacki (2002) finds that some car manufacturers reduce prices while some do not in response to entry. He argues that incumbent pricing responses to entry are firm-

specific, depending on the incumbent's ability to respond to entry, which in turn depends on its relative resource position.

In industries with differentiated products, firms have a variety of tools available to them for responding to new entry. These tools include advertising and promotional campaigns, and new product innovations, which may be used instead of or in addition to price responses (Thomas, 1999). There is also evidence that firms in highly differentiated industries use advertising to deter or limit entry (Thomas, 1999). But this argument fails to explain why incumbents in the airline and auto industry cut prices after entry (Windle and Dresner, 1995). Simon (2005) offers a more general explanation for why some firms respond to entry more aggressively than others: incumbents vary in their incentive to respond to entry. Several factors influence the incumbents' response to entry such as the incumbent's age, the incumbent's scope of services, and the market structure. But low entry barriers in the magazine market may explain the absence of a pricing response across all the incumbents in his study. Table 3 summarizes the empirical studies of incumbent pricing responses to entry.

**Table 3. Empirical findings of incumbent pricing responses to entry**

Authors	Industry	Key Result
Joskow, Werden & Johnson (1994)	Airlines	Incumbents cut prices post entry
Windle & Dresner (1995)	Airlines	Incumbent cut prices following entry
Marion (1998)	Grocery Stores	Incumbent supermarkets cut prices following entry by warehouse stores
Thomas (1999)	Cereal	Incumbents accommodate on prices
Frank & Salkever (1997)	Pharmaceuticals	Incumbent producers of prescription drugs raise prices after generic entry. Generic incumbents reduce prices after entry.
Bresnahan and Reiss (1991)	Local Retail Markets	Incumbents reduce prices following entry
Yamawacki(2002)	Automobiles	Firm specific and Group specific factors influence response to entry
Simon (2005)	Magazines	Firm specific and Industry specific factors influence response to entry

*Incumbent pricing expectation in an audit setting*

Marketers have suggested that, while the basic concepts of marketing remain the same across industries, professional services firms have characteristics that set them apart from their

manufacturing counterpart (Crittenden et al, 2003). In the market for services, Monroe (1989) suggested that most organizations have traditionally followed a naive and unsophisticated approach to pricing. Murdock and McGrail(1994) go so far as to suggest that accountants ‘avoid overtly using price as part of an overall marketing program’(pp.17). However, DeAngelo (1981) argued that prices are used by accounting firms to gain new clients and that rational auditors charge lower audit fees in the first few years of their engagement as they know that they will be able to earn excess profits in the later years, a strategy known as “lowballing”. The longer the association of the auditor with the client, the more knowledgeable the auditor is about the operations of the client and its industry. Such knowledge is very helpful as it allows the auditor to improve audit efficiency and effectiveness. When bidding on a new engagement, rational auditors are aware that they have an opportunity to earn excess profits in the later years of their relationship. Therefore, auditors tend to reduce the fee bid in the early years to attract the clients. Ettredge and Greenberg (1990) actually found that the initial fees charged by the new auditors were about 25% lower than the last fees charged by their predecessors. Further, in the Indian setting, it can be argued that the Big Four accounting firms might adopt the strategy of “lowballing” to gain access to a client for the purpose of providing non-audit services or to gain recognition in the local market.

Along with the “lowballing” theory, there is also evidence that the Big Four accounting firms command price premiums (Francis and Simon, 1987; Palmrose, 1986). This premium has been primarily explained with two different arguments. First, DeAngelo argued that clients use the size of the accounting firm as a quality surrogate and therefore large accounting firms such as the Big Four accounting firms are perceived to supply higher levels of audit quality as compared to the smaller firms. She argues that audit quality is difficult to evaluate because of the inherent

nature of auditing. Thus, rational consumers devise alternative arrangements to find out the quality of audit services provided by different accounting firms and therefore they use auditor size as a surrogate for audit quality (DeAngelo, 1981). The other argument is based on the brand name model of Klein et al. (1981) in which the Big Four accounting firms are expected to develop and maintain brand name reputations for quality in order to secure and protect quasi-rents arising from the brand name (Johnson and Lys, 1990). In other words, the brand-name development comes first and this in turn leads to a quality-assuring price that is higher than the minimum-quality price.

Local accounting firms would be faced with either a “lowballing” strategy likely to be adopted by the Big Four accounting firms entering the market or a higher Big Four premium due to the perceived higher quality of services provided by the Big Four accounting firms and the brand reputation of the Big Four accounting firms. It is necessary to mention here that Pearson and Trompeter (1994) argued that the brand reputation of the Big Four accounting firms would reduce the likelihood of a “lowballing” strategy by the Big Four accounting firms. If the Big Four accounting firms adopt a “lowballing” strategy, the local accounting firms are more likely to lower their fees to meet the challenge posed by the Big Four accounting firms. However, when there are client specific start-up costs associated with the audit market, incumbent auditors have certain cost advantages over the potential competitors for a certain client. They are already well acquainted with the operations and accounting practices of the client and have qualified staff that has developed a working relationship with the management of the client firm, that is “incumbent auditors earn client specific quasi rents” (DeAngelo, 1981, pp.184). This suggests that the termination of the audit relationship would impose costs on both parties, the auditor and the client. In the event of termination, the incumbent auditors would lose the “wealth equivalent of

the client-specific quasi-rent stream” (pp. 188) and the clients would have to bear the transactions costs of seeking services of new auditors and start-up costs of training the new auditors to get them familiarized with the operations of the organization (DeAngelo, 1981). Further, there is a value placed by the clients on the higher quality of service and brand reputation of the Big Four accounting firms; say, the premium value. Therefore, I argue that the local accounting firms would lower their fees if they believe that the sum of the premium value and the discount offered by the Big Four accounting firms adopting a “lowballing” strategy would exceed the high direct costs likely to be incurred by the clients to switch auditors. On the other hand if rational auditors of the local accounting firms reckon that the transaction costs of switching and duplication of start-up costs associated with training a new auditor are higher than the sum of the premium value and the discount offered by the Big Four accounting firms, they would meet the challenge posed by the competitors by increasing the scale of their audit services or other non-pricing measures.

On the other hand, if the Big Four accounting firms charge a higher premium right from the outset due to their perceived higher quality of services and brand reputation, it would not make sense for the incumbent accounting firms to reduce their fees as their existing fees are expected to be lower than the audit fees charged by the Big Four accounting firms. This course of action of the incumbent accounting firms would depend on the premium value. If the premium value is more than the sum of the fee difference between the Big Four accounting firm and the incumbent accounting firm and the transaction costs of switching auditors, the client would switch from the local accounting firm to the Big Four accounting firm. In such a scenario, the incumbent accounting firm could be expected to reduce its audit fees to retain the client as long as it is still making economic profits. This in turn would depend on the profit margins of the

incumbent accounting firms. Given the absence of foreign competition in the local accounting services market before the entry of the Big Four accounting firms, the margins of the incumbent accounting firms can be expected to be high enough to sustain a reduction in audit fees to deter entry.

There is little empirical evidence which provides support for limit pricing strategies and most of the empirical studies found that firms rarely use pre-entry pricing to deter entry. In case of pricing strategies predicted by the game theoretic models, low prices have to be maintained post-entry and when the entrant is not aware of the incumbent's pay-offs, the incumbent has incentive to cut prices post-entry to deter the entrant (Kreps and Wilson, 1982). This is particularly relevant in the Indian audit market, where the Big Four accounting firms are not likely to possess knowledge about the cost structure and profit margins of the local accounting firms. This would provide additional incentive to the local accounting firms to cut prices after entry to drive out the Big Four accounting firms.

## **Hypotheses and Research Methodology**

### *Preliminary Analysis: Estimation of Big Four Premium*

Before developing the hypotheses for the research questions in the study, it is important to analyze the relevance of the audit fee model in the Indian audit market because I intend to use the model to test the pricing response of the local accounting firms to the entry of the Big Four accounting firms. The market for audit services has been studied extensively in the developed countries including United States of America (Simunic, 1980), United Kingdom (Taylor and Baker, 1981), Australia (Simon and Francis, 1988), and in New Zealand (Firth, 1985). However, little work has been done in developing countries on the determinants of audit fees except for Simon et al. (1995) and Karim et al. (1996). Karim et al. (1996) analyzed the determinants of



audit fees in Bangladesh, whereas Simon et al. (1995) examined the determinants of audit fees for public sector companies in India and compared their fees with fees for private sector companies in the same market. Both the studies found the audit fee model to be relevant in India and Bangladesh.

In this study, for completion purposes, I intend to start with an analysis of the relevance of the audit fee model in the Indian audit market. This will allow for a direct comparison with the studies done in Hong Kong and the larger countries of America and Australia. If the audit fee variables which have been known to be determinants of audit fees in prior studies are also found to be related to audit fees in the Indian audit market, we can conclude that the audit fee model is relevant in the Indian audit market. For instance, total assets have been empirically found to be one of the determinants of audit fees and they have also been found to be positively related to audit fees. If total assets are, therefore, found to be positively related to audit fees in the Indian audit market, it can be concluded that the audit fee model is relevant in the Indian audit market.

#### *Hypothesis 1: Price cutting by the local accounting firms*

There are two kinds of pricing strategies adopted by incumbents in the face of entry: those that predict pre-entry pricing response and those that predict a post-entry pricing response. In the first category are limit pricing models in which incumbents set a pre-entry price below the current profit maximizing level as a way to reduce the potential entrants' assessment of the benefits of entry. In the second category are game-theoretic models in which incumbents reduce prices post-entry to drive out entrants and deter future entrants (Simon, 2005). In the Indian audit market, the Big Four accounting firms would either lower their initial fees to get new clients and gain entry, a strategy known as "lowballing", or due to their perceived higher quality of services and brand reputation, they would charge a premium for their services. If the Big Four accounting

firms adopt the latter strategy, the local accounting firms would be more likely to maintain their audit fees as their fees would already be at a discount compared to the higher fees to be charged by the Big Four accounting firms, except for the case when the premium value is higher than the sum of transaction costs of switching auditors and the fee difference between the Big Four accounting firm and the incumbent firm. In the latter case, the incumbent firms are more likely to reduce their audit fees to retain their clients. If the Big four accounting firms adopt a “lowballing” strategy, the local accounting firms would compare the transaction costs associated with switching auditors with the sum of the premium value and the discount offered by the Big Four accounting firms. If the transaction costs are higher than the sum of the premium value and the discount, the local accounting firms would not reduce their fees and if the transaction costs are lower than the sum of the premium value and the discount, the local accounting firms would lower their audit fees to deter the Big Four accounting firms.

In case of pre-entry pricing strategy, if economies of scale require entrants to achieve at least a minimum market share, and if they believe that incumbents will not change their pre-entry prices post entry, then an appropriate choice of pre-entry prices by the incumbent will ensure non-positive post- entry profits for the entrant. The limit pricing strategies make sense for incumbents if the foregone pre-entry profits are less than the present discounted value of the entire stream of post-entry profits, relative to what incumbents would have earned if entry had occurred (Geroski, 1995). This calculation, in turn depends on the speed with which entrants penetrate the market, on market growth, and above all, on the height of entry barriers. If the barriers to entry are high, firms will not have to cut prices much below monopoly levels to deter entry, while if barriers to entry are low then the market is effectively competitive and the best

strategy for incumbents would be to not cut prices and maximize the monopoly profits in the short run (Geroski, 1995).

In the Indian audit market, post the liberalization reforms in the early 1990s, the barriers to entry were considerably reduced in the consulting services of the market, although the audit market was still protected by legislation (CAAC, 2002). The local accounting firms would therefore be expected to reduce fees for their audit services, but not cut prices for consulting services, essentially non-audit fees. Further, the Big Four accounting firms would be expected to penetrate the market quite rapidly due to their brand reputation and perceived higher quality of service and therefore, the local accounting firms would be expected to forego some of their pre-entry profits to deter entry by the Big Four accounting firms. Another drawback of the limit pricing strategy is that while it makes sense to threaten to reduce prices pre-entry, an incumbent faced with the actual fact of entry will wish to maintain high prices (jointly with the entrant) post-entry. In other words, the threat to maintain high pre-entry prices indefinitely in the post-entry future may not be persuasive to a sophisticated entrant, in this case, the Big Four accounting firms with a long history of entry in world markets.

In case of differentiated product markets, the incentive to cut prices is weaker because demand is more inelastic with respect to price and more elastic with respect to other marketing tools. In such cases, firms may not react with prices but respond aggressively with another competitive strategy (Gruca, Kumar, and Sudarshan, 1992). The intangible nature of accounting and auditing work results in some level of product differentiation in the audit market (Parasuraman et al., 1985; Schonberger, 1980). That is, Big Four accounting firms could be providing a different level of 'audit risk', 'assurance level', or 'insurance' as compared to a Non-Big Four accounting firm. However, firms in differentiated markets may also respond with more

than one competitive weapon (Gatignon and Hanssens, 1987). Extant marketing literature argues that incumbents in differentiated markets almost always reduce prices post-entry (Hauser and Shugan, 1983; Kumar and Sudarshan, 1988; Gruca et al., 1992). In light of the discussion above, I offer the following hypothesis in the alternative form:

*Hypothesis 1: Local accounting firms significantly reduced their audit fees post-entry by the Big Four accounting firms.*

*Hypothesis 2: Effect of Market structure on the pricing response of local accounting firms*

Market structure may also influence the incumbents' incentive to respond to entry. Prior research has shown that the threat posed by entry is greater in concentrated markets (Hannan, 1979). In competitive markets, entry should have little effect on incumbents as competition has already forced high prices down towards marginal cost, while in more concentrated markets, entry threatens to erode rents by making it more difficult to maintain tacit collusion. Therefore, incumbents in highly concentrated markets have a greater incentive to cut prices, both to drive out entrants and to defer further entry (Hannan, 1979; Kessides, 1990). Alternatively, it has also been argued that higher concentration may reflect entry barriers or incumbent capabilities which make it more difficult for new firms to enter the market (Simon, 2005). Hannan (1979) finds that incumbents in concentrated markets cut prices more in response to entry. In 2001, the Indian audit market was comprised of 52 medium sized accounting firms (No of partners > 10) and approximately 42,000 small sized accounting firms (CAAC, 2002). Market competition induces clients and accounting firms to align themselves to achieve efficient utilization of specialized resources and therefore, accounting firms that normally audit small, unregulated clients may be unable to offer their services at competitive prices to large, geographically dispersed corporations because they lack the economies available to firms already serving in the

market segment (Johnson and Lys, 1990). Conversely, firms that typically audit large geographically dispersed clients will be unwilling to allocate productive resources to small localized corporations at competitive prices. Auditors of comparable size and clientele mix can thus be expected to have similar cost structures (Johnson and Lys, 1990). It follows that medium sized accounting firms are more likely to compete for large Indian companies for audits and therefore, the market for large auditees is likely to be highly concentrated due to the small number of medium sized accounting firms. Conversely, the market for smaller auditees is likely to be more competitive due to the large number of small sized accounting firms operating in the Indian market. It is reasonable to expect the Big Four accounting firms to target the largest companies in the Indian market to penetrate the market. It follows that the medium sized firms are more likely to be threatened by the entry of the Big Four accounting firms and therefore are more likely to reduce prices, whereas the small sized firms are not likely to reduce prices as competition has already forced down prices in the small auditee segment of the Indian market.

*Hypothesis 2: Local medium sized accounting firms y reduced audit fees significantly more than local small sized accounting firms in response to entry.*

### **Sample Selection and Model Specification**

To test these hypotheses, I use data from the Indian audit market. Per the provisions of the Indian Companies Act 1956, all public companies are required to disclose audit fees and non-audit fees in annual reports. The data span a ten year period from 1996 to 2005. The sample includes 206 randomly selected publicly held companies from the Bombay Stock Exchange -500 Index (hereafter, BSE-500). In total, there are 2060 client-year observations. Finance companies and Banks will be excluded from the sample selection process, as it has been established before

that most of the financial ratios used in the model cannot be determined in case of finance companies (Simunic, 1980).

Regression analysis will be the major statistical technique utilized in the empirical analysis. Two OLS regression models are to be specified:

- (1) First, to test the relevance of the audit fee model in the Indian audit market, a cross-sectional audit fee model will be used for the full sample of companies for the year 2005. These audit fee models use a variety of variables to control for different factors that have an impact on audit fees such as client size, audit complexity, and auditor-clients risk sharing (Simunic, 1980). Simon and Francis (1988) and Chan et al. (1993) have shown that these models have demonstrated relatively high explanatory power ( $R^2$  of 0.65 or higher) and have been robust across different samples, time periods, and countries, and to sensitivity analyses for model misspecification.

**Model 1:**

$$\text{LAUD} = b_1 + b_2\text{LTOT} + b_3\text{LOSS} + b_4\text{DE} + b_5\text{CARAT} + b_6\text{IAUDITOR1} + b_7\text{IAUDITOR2} + b_8\text{SUBS}$$

Where,

LAUD = the natural logarithm of audit fees

LTOT = the natural logarithm of total assets

CARAT= current assets divided by total assets

DE = long-term debt divided by total assets

LOSS = indicator variable (1= loss reported in current or prior year)

IAUDITOR1 = indicator variable (1= Medium local accounting firm)

IAUDITOR2 = indicator variable (1= Small local accounting firm)

SUBS = Square root of subsidiaries

- (2) Second, to investigate the pricing response of incumbent firms, a longitudinal fixed effects audit fee model will be used for the full sample for the entire data span (1996 to 2005). In the fixed effects specification, only within- accounting firm variation and within-client variation is used. In this model, the purpose is to compare the audit fees charged by incumbent accounting firm to its client at the time of entry, which is the year, 1996 with the audit fees charged by the same accounting firm after entry over the period of 10 years, averaging the difference across all the incumbent accounting firms in the sample.

**Model 2:**

$$\text{LAUD} = b_1 + b_2\text{LTOT} + b_3\text{LOSS} + b_4\text{DE} + b_5\text{CARAT} + b_6\text{ROI} + b_7\text{IAUDITOR1} + b_8\text{IAUDITOR2} + b_9\text{ENTRY}$$

Where,

LAUD = the natural logarithm of audit fees

LTOT = the natural logarithm of total assets

CARAT = current assets divided by total assets

ROI = Net Income divided by total assets

DE = long-term debt divided by total assets

LOSS = indicator variable (1= loss reported in current or prior year)

IAUDITOR1<sup>4</sup> = indicator variable (1= Medium local accounting firm)

IAUDITOR2 = indicator variable (1= Small local accounting firm)

ENTRY= indicator variable (1 = 1996 to 2000)

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<sup>4</sup> For this variable, the local accounting firms which merged with the Big Four accounting firms will be classified as incumbent accounting firms till the year of merger and after year of merger, they will be classified as Big Four accounting firms.



**Table 4. Models and Hypotheses**

Hypotheses	Models	Variables of Interest	Expected sign
Preliminary	Model 1	LTOT	+
		CARAT	+
		DE	+
		LOSS	-
		SUBS	+
		IAUDITOR1	-
		IAUDITOR2	-
Hypothesis 1	Model 2	ENTRY	-
Hypothesis 2	Model 2	IAUDITOR1 > IAUDITOR2	-

Table 4 provides a description of all the hypotheses and models used in the study along with the expected signs of the variables of interest. In Model 1, LTOT, CARAT, DE, LOSS, IAUDITOR1 and IAUDITOR2 are the variables of primary interest and are intended to assess the relevance of the audit fee model in the Indian audit market. Based on previous studies, LTA is intended to control for client size, while CARAT, SUBS and DE control for audit complexity and risk. All four variables are expected to be positively related to audit fees. LOSS is expected to be negatively related to audit fees. IAUDITOR1 and IAUDITOR2 are intended to assess the extent, if any, of a Big Four premium in the Indian audit market (Davis et al., 1993; Firth, 1985; Simunic, 1980). IAUDITOR1 has been defined as any local accounting firm with more than fifteen partners, whereas IAUDITOR2 has been defined as any local accounting firm with less than ten partners<sup>5</sup>. Logarithmic transformations of fees and assets are employed because previous

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<sup>5</sup> None of the local accounting firms in the sample had between 10 and 15 partners and therefore I classified the small and medium sized accounting firms based on the above limits.

research in this area (Simon and Francis, 1988) has indicated that this specification provides a good linear fit in which the assumptions of ordinary least squares regression are satisfied.

In Model 2, I measure entry with a dummy variable (1 = 1996 to 2000) for all the incumbent firms in the sample and this variable is expected to be negatively related to LAUD, indicating that the incumbent auditors reduced prices following entry by the Big Four accounting firms (Hypothesis 1). Further, the coefficient size of IAUDITOR1 will be compared with the coefficient size of IAUDITOR2 to determine whether market structure moderates the pricing response of the incumbent firm (Hypothesis 2).

## **Results**

### *Preliminary Analysis: Estimation of Big Four premium*

Table 5 presents the results of the preliminary analysis conducted to examine the effectiveness of the audit fee model in the Indian market. The cross sectional sample includes all the 206 firms from the BSE-500 index for the year 2005. The variables used to estimate audit fees are the same variables used in prior audit market studies (Simunic, 1980; Craswell et al., 1995). Prior studies (mainly using U.S. and Australian data) have documented a brand-name premium for the Big 6 auditors. Simon and Francis (1988) report a premium of 16 percent of total audit fees in a study using U.S data and calculate that the Big 6 premium averages 18% across a number of other studies using either U.S or Australian data. Craswell et al. (1995) use a much larger sample and estimate a Big 6 premium of 31% in Australia. We replicate and extend the design used by Craswell et al. (1995). The model is significant at  $P < 0.01$  and has an adjusted  $R^2$  of 39%. The IAUDITOR1 variable is negative but statistically insignificant, whereas the IAUDITOR2 variable is negative and statistically significant, which means that a premium is

paid to the Big Four auditors in India as compared to the small sized accounting firms. The coefficient of -0.336 in the regression estimation translates to a premium of 48%.<sup>6</sup>

**Table 5. Preliminary Analysis: Estimation of Big Four premium**

Variables	Coefficient	t-statistic	Probability
Intercept	2.044	4.305	0.000
LOGTOT	0.553	8.868	0.000
LOSS	0.148	2.420	0.016
DE	-0.145	-7.81	0.000
CARAT	0.135	5.870	0.000
IAUDITOR1	-0.092	-1.504	0.134
IAUDITOR2	-.336	-5.484	0.000
SUBS	0.185	3.341	0.001
F-Statistic	19.129	0.000	
Adjusted R <sup>2</sup>		39%	

This is higher than the average 16 to 18 percent premium in U.S. studies (see Simon and Francis 1988) and also higher than the Big 6 premium of 31% in Australia (Craswell et al., 1995). This can be explained by the absence of many larger sized Non- Big Four accounting firms in the

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<sup>6</sup> A procedure to derive the impact of the auditor intercept shift on the dependent variable (which is the natural log of audit fees) is reported by Simon and Francis (1988, 263).

Indian market. As noted elsewhere in the paper, the number of firms with partners greater than 10 is only about 42 out of the total number of around 42,000 firms. Defond et al (2000) also found that the Big 6 premium in Hong Kong was much larger than the premium found in U.S. and Australian studies due to the same reason.

### *Incumbent Pricing Results*

Table 6 provides descriptive statistics and a correlation matrix. Looking at the sample means, the incumbent pricing responses are being measured for the first six years of the time period from 1996 to 2005, about 44%. The medium sized accounting firms represent about 23% of the sample while the small sized accounting firms represent about 46% of the sample, the rest being the Big Four accounting firms. The correlation matrix in Table 6 is a ‘within’ correlation matrix. That is, the correlations reflect only the variation within each panel (client). This corresponds to the fixed-effects model which only exploits the variation within each panel (client). As can be seen from the correlation matrix, multicollinearity does not seem to be a problem<sup>7</sup>.

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<sup>7</sup> All the VIF reported were less than 1 in the entire sample.

**Table 6. Descriptive statistics and within-client correlation matrix**

Variable	Mean	S.D	1	2	3	4	5	6	7	8	9	10
LOGAUD	5.76	.51	1.00	.53	.14	.04	-.15	.003	-.33	.16	-.29	.24
LOGTOT	9.67	.62	.532	1.0	-.126	.046	.061	-.386	-.073	.111	.014	.068
ROI	.10	.12	.146	-.126	1.000	-.271	-.339	.285	-.136	-.001	-.110	.012
LOSS	.06	.24	.041	.046	-.271	1.000	.170	-.068	-.033	.030	-.024	.015
DE	.38	.31	-.150	.061	-.339	.170	1.00	-.193	.080	.016	.101	-.009
CARAT	.69	.41	.003	-.386	.285	-.068	-.193	1.000	-.109	-.067	-.116	.012
ENTRY	.44	.49	-.330	-.073	-.136	-.033	.080	-.109	1.000	.220	.294	.006
IAUDITOR1	.23	.41	.166	.111	-.001	.030	.016	-.067	.220	1.000	-.505	.090
IAUDITOR2	.46	.49	-.292	.014	-.110	-.024	.101	-.116	.294	-.505	1.000	-.085
SUBS	1.96	3.579	.240	.068	.012	.015	-.009	.012	.006	.090	-.085	1.000

Table 7 reports results for the model used to test the hypotheses 1 & 2. In this model, the coefficient for ENTRY is negative and statistically insignificant providing support for Hypothesis1 and suggesting that, on average, incumbent accounting firms cut prices post entry by the Big Four accounting firms in the Indian audit market. The coefficient value is -0.19, which suggests that local Indian accounting firms, on average, cut prices by around 19% in the first five years from 1996 to 2000. The variables of IAUDITOR1 and IAUDITOR2 are also negative and statistically significant with values of -.12 and -.40 respectively, thereby failing to provide support for hypothesis 2. However, the result suggests that small sized local accounting firms cut prices more than the medium sized accounting firms. While the small sized accounting firms reduced prices by around 40% over the ten year period, the medium sized accounting firms reduced prices only by around 12% over the same period. The reasons for the same will be discussed in the next section.

**Table 7. Incumbent Pricing- Audit fee estimation from 1996-2005**

Variables	Coefficient	t-statistic	Probability
Intercept	-1.226	-5.560	0.000
LOGTOT	0.755	33.910	0.000
LOSS	0.044	2.090	0.030
DE	-0.145	-7.810	0.000
CARAT	0.135	5.870	0.000
ROI	0.212	0.048	0.000
ENTRY	-0.194	-17.39	0.000
IAUDITOR1	-0.124	-4.330	0.000
IAUDITOR2	-0.402	-8.380	0.000
SUBS	0.008	0.790	0.428
F-Statistic	29.950	0.000	
Adjusted R <sup>2</sup>	88%		

## **Discussions and Conclusions**

Economic theory suggests that incumbent firms may cut prices after entry either to deter future entrants or to maximize current profits. However, empirical research so far has produced inconsistent results: some studies, including the current paper, find a negative relationship between entry and pricing, while others do not.

Regarding the direct effect of entry, the results of this study indicate that entry does have a statistically significant effect on incumbents' pricing in the Indian audit market. One industry-specific explanation for the effect of entry may be the relatively low rate of entry in the audit market due to entry barriers. Because entry was rare in the Indian audit market, the incumbent accounting firms were motivated to cut prices to protect their monopolistic profits (Hannan, 1979; Cool, Roller, and Leleux, 1999). In other words, prior to the entry of the Big Four accounting firms, the Indian audit market was a protected market in which incumbents were charging high audit fees not fearing entry in the market. Another explanation for the significant pricing response could be the emphasis on the long term effects of entry, around 10 years, in this paper as opposed to other studies which mainly examined the short run effects of entry (Geroski, 1995).

Hypothesis 2 was not supported. In fact, the results indicate that small sized accounting firms cut prices more than the medium sized accounting firms. There can be various reasons for these results. Firstly, as discussed in the earlier part of the paper, the pricing responses of the local accounting firms would depend on a large extent on the premium value assigned to the Big Four accounting firms by the clients of the local accounting firms. It can be reasonably asserted that the premium value assigned to the Big Four accounting firms by clients of the small sized accounting firms would be higher than the premium value assigned by the clients of the medium



sized accounting firms. Therefore, it follows that the small sized accounting firms might have been more threatened by the entry of the Big Four accounting firms than the medium sized accounting firms and might have been more inclined to cut prices to deter entry. Further, the sample of firms used in the paper could also provide some explanation for the results of Hypothesis 2. The sample of firms was randomly selected from the BSE- 500 index, which would consist of the largest firms in the Indian market. These firms can be expected to contribute a significant proportion of the audit fee revenue for the small sized accounting firms. It follows therefore that the small sized accounting firms would be motivated to retain these clients and therefore would be more likely to cut prices for these clients.

Another explanation for the more aggressive pricing responses of the small sized accounting firms as opposed to the medium sized accounting firms could be explained by the argument by Smith, Grimm and Gannon ( 1992), who suggested that firms with more complex organizational structures are less likely to respond to competitive attacks and entry. They posit that in structurally complex firms, decision makers receive information more slowly and are more likely to receive misinformation. This weakens the ability of these firms to respond to entry. The lack of aggressive pricing responses of the medium sized accounting firms may be explained by these organizational factors.

Finally, while Hypothesis 2 was based on the argument that incumbents in concentrated markets cut prices more in response to entry, it has also been argued that higher concentration may reflect entry barriers or incumbent capabilities which make it difficult for new firms to enter the market. In this case the entry barriers would grant the incumbents a competitive advantage over new entrants, reducing the need for incumbents to respond aggressively to entry (Simon, 2005).

There are some limitations in this paper which need to be addressed. One concern with this study is that local accounting firms may respond to entry with non-price weapons. For instance, incumbent firms may increase their advertising expenditures or upgrade the quality of their services or provide more services at the same price. These non-price responses however, may tend to be cost increasing, leading to price increases. As a result, these non-price responses may cause a spurious, positive relationship between entry and price (Simon, 2005). This may create a bias against finding a negative relationship between entry and price, thereby strengthening the results found in this paper.

Another drawback in this paper is the absence of non listed companies in the sample. It could be possible that the small sized accounting firms reduced prices for their listed clients but not for the small privately held companies. It would be interesting to examine the responses of the local accounting firms in the private sector of the Indian industry. One might also be concerned that changes in supply conditions, for example, a reduction in costs due to technological innovations could lead to lower prices, yielding a downward bias in the coefficient on entry (Geroski, 1995). However, this is unlikely in a single industry setting because factors that reduce production costs would be likely to affect all the accounting firms, regardless of the type of client they audit. This effect would be captured by the year fixed effects (Simon, 2005).

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## **CHAPTER THREE: STUDY TWO: IMPACTS OF GLOBALIZATION: EVIDENCE FROM THE INDIAN ACCOUNTING PROFESSION**

### **Introduction**

In the last two decades, globalization has become an integral part of the development strategies of many countries in Eastern Europe and Asia. Even though the apparent goals of globalization are world trade and investment without any barriers, it has been documented that globalization has only been used by the stronger nations to subjugate the weaker nation states (Caramanis, 2002). There has been a lot of prior research on the role of international agencies in the regulation of accountancy (Chua and Poullaos, 1993; Puxty et al., 1987; Sikka and Wilmont, 1995). Prior research has highlighted the control exercised by the British and American accounting associations over the development of indigenous accounting professions in colonial and post-colonial societies (Anisette, 2000; Caramanis, 1999; Chua and Poullaos, 1998, 2002; Johnson, 1973). However, as Caramanis (2002) points out, none of the above mentioned research efforts have analyzed the impact of globalization on the local accounting practices, discourses and institutions, especially those that deal with contemporary processes and events (Hopwood, 1994; Moizer, 1992). Also, Arnold (2005) reiterates that further case study research is needed to show how the process of globalization will affect local accounting practices and institutions and how the World Trade Organization (hereafter, WTO) members from nations outside the metropolitan center such as India, Brazil, and China will adapt to “transatlantic hegemony”(2005:323).

This main thesis of this paper is to respond to the calls by Caramanis (2002) and Arnold (2005) to enforce the view that globalization is not a natural and inevitable process, but that it is

a politically constructed institution that is driven by powerful international bodies such as multinational accounting firms and the International Monetary Fund (hereafter, IMF), using the instruments of coercion and pressure. Specifically, I intend to explore the interconnectedness of professional and state politics with global forces by examining the role played by professional associations and the state in the process of globalization.

While Caramanis (2002) examined the effect of developing patterns of global interconnections upon accounting decision making at the level of the nation-state, I intend to expand the analysis to examine the impact of globalization on the regulation of accounting by professional associations. These associations act as negotiating or representative agencies, shaping and defining appropriate practices of interaction for their members (Greenwood et al., 2002). They also act as the means whereby communities represent themselves to people outside the field. This role of professional associations makes them active players in the process of globalization. These associations along with the local government and the regulatory agencies are one of the first frontiers encountered by the forces of globalization in the accounting field.

The empirical portion of the paper is undertaken in the context of the accounting profession in India from 1990 to 2005. During this period, the Indian accounting profession underwent major changes both in terms of its market structure and jurisdiction. The change was precipitated by the foreign exchange crisis that almost turned the country bankrupt in 1991. To deal with the shortage of foreign exchange reserves leading to non payment of external debt, the government of India requested a Stand-By Arrangement from the IMF in August 1991 (Clark et al., 2003). One of the stipulations of the Stand-By Arrangement was that the multinational accounting firms<sup>1</sup>, essentially the Big Four accounting firms, be allowed to provide consulting

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<sup>1</sup> The terms “multinational accounting firms” and “Big Four accounting firms” refer to the same constituents and therefore are used interchangeably throughout the paper.



services in India (CAAC, 2002). Consequently, the Reserve Bank of India issued special licenses to the multinational accounting firms authorizing them to provide consulting services in India. The analysis will focus on the catalytic role played by powerful international agents over the jurisdiction of the Indian accounting profession and the ability of these actors not only to overcome the resistance of local professional bodies but also influence the policies of the local regulatory agencies, banks, and financial institutions to the prejudice of the local accounting profession in a weak nation state such as India. The results will show how the multinational accounting firms, “well positioned in the international economic system”(Caramanis, 2002:380) are capable of not only changing the boundaries of the local accounting profession , but also becoming competitive forces in the market in a relatively short span of time from 1990 to 2005.

The paper mainly draws upon an academic exercise by the Chartered Accountants Action Committee For Level Playing Field( hereafter, CAAC) about the entry of the multinational accounting firms in India in the form of a white paper , which was published in 2002. The CAAC emphasized that the white paper was published in the “public interest to inform the Indian industry, Indian finance sector, Indian Government, Indian policy makers, Indian professionals, and also the general public about the correct facts of the multinational accounting firms (MAFs) and about the state of the Indian profession.” (CAAC, 2002: 2). The white paper points out that the change in attitude of the Indian government towards globalization and liberalization in the early 1990s was not a deliberated national decision, but it was compelled and driven by the foreign exchange crisis that almost turned the country bankrupt in 1991. Further it is argued that an impulsive reaction to this crisis resulted in a defocused liberalization program, without seeking the inputs and opinions of the stakeholders who would be affected by

the liberalization agenda, such as the Indian companies, the Institute of Chartered Accountants of India (hereafter, ICAI) , or the Indian accounting firms (CAAC, 2002).

The remainder of the paper is organized into the following sections. Section II looks at the prior research in the field of globalization and summarizes the insights from a diverse body of academic literature which forms the basis for my analysis. Section III describes the research methodology and provides a brief background of the Indian accounting profession. Section IV presents an analysis of the empirics examining the entry of the multinational accounting firms in India, the role played by the ICAI in the process of entry, and highlights certain theoretical issues. Finally, Section V summarizes the analysis, draws together the main points of the discussion and provides directions for future research.

### **Theoretical Context**

#### *Theoretical perspectives on globalization*

Giddens defined globalization as “a process of increasing interconnectedness between societies in a dialectical fashion such that events in one part of the world more and more have effects on peoples and societies far away and vice versa” (1990: 64). Research on globalization is voluminous and diverse in content as the concept has been studied from various perspectives. These different perspectives include economy and polity( Camillieri and Falk, 1992; Dicken, 1992; Held, 1991) , international relation and politics( Cox, 1996), trading blocks and the global financial system( Frieden, 1989), sociology and culture( Featherstone, 1990), domestic regulation and the market for professional services( Caramanis, 2002; Arnold ,2005). Some extreme views signal the end of the nation-state (Ohmae, 1996; Camilleri & Falk, 1992), while some views emphasize the state’s resistance to attacks on its sovereignty by international agents (Hirst & Thomson, 1992, 1995). The common thread among all the diverse topics is the

consensus that there has been a remarkable shift of power from the sovereign state to multinational economic institutions such as the IMF and the World Bank. (Chase-Dun, 1989; Dicken, 1992; Kennedy, 1993). The extent of sovereign power exercised by a state can be determined by understanding the gap between the political power proclaimed by them and the actual practices and the economic system at the national regional and global levels. (Caramanis 2002). Thus from a domestic perspective, one needs to look at the interests of the local political actors, and corporate bodies influencing the decisions of the nation state, whereas from an international perspective, the power of the nation state to exercise sovereignty needs to be studied in relation to the world economy and international economic and military alliances, which set constraints on the sovereign power (Caramanis 2002). The current paper plans to examine the event of the entry of the multinational accounting firms from an international perspective on globalization. In other words, the analysis will focus on the influence of international economic institutions such as the IMF and multinational bodies such as the multinational accounting firms on the sovereignty of a weak nation state such as India and consequently on the local accounting profession.

There are four themes in the study of globalization examined by Held (1991) and clarified by Caramanis (2002) which are relevant to the current paper. First, it is argued that multinational or transnational corporations have become 'floating' international agents. While it has been documented that transnational corporations have strong links with their country of origin( Cox, 1996), it is important to note that a multinational business is influential enough within a major nation-state to influence the policies of that state in an attempt to expand internationally and make an entry into markets of weaker nation-states (Caramanis, 2002). In turn, these major nation-states exert pressure on international organizations such as the IMF or

the World Bank and use international trade agreements to exert influence on the weaker nation-states such as India, which would wish to protect its own markets (Arnold, 2005). Second, it has been argued that while some nation-states such as the USA have the power and the resources to resist international pressures on their economic policies, weaker nation-states such as India in this case are more vulnerable in the management of their national economy (Cooper, 1986; Gilpin, 1987). Third, some neorealist views emphasize a benign outcome of domination of one state by another: the achievement of international order (Keohane, 1980). In a sense, these hegemonic states serve as the establishers and underwriters of public goods, such as order and openness and the existence of these states is necessary for the development of a world market economy (Gilpin, 1987). Finally, these hegemonic states have the power to support and maintain the international regime they favor, using a variety of coercive tools such as enforcement, enticements or bribes to convince other states to remain within the confines of the regime (Caramanis, 2002).

*Theoretical Model: Institutional model of globalization*

In the backdrop of the ‘globalization’ economy described above, the current paper employs the institutional model of globalization (Arnold, 2005) to examine the entry of the Big Four accounting firms in India. The conventional wisdom, which Arnold (2005) calls the market model of globalization argues that advances in technology have precipitated the growth of global financial markets. These global markets, in turn, require transparency in financial reporting to function effectively. This goal is served by the accounting and auditing disciplines by mitigating agency problems and reducing transactions costs. The role of the accounting profession in this model is reactive: the accounting profession must adapt and modernize in order to facilitate the smooth functioning of markets. This model, therefore, argues for adaptive responses ranging

from global professional credentialing to adoption of international accounting standards. The market model considers resistance to change on the part of nations-states and the accounting profession in these nation- states as rigidity that must eventually give way to the inevitable forces of globalization.

The institutional model of globalization, on the other hand, argues that the multinational accounting firms, with the help of their strong nation states of origin and international economic institutions, have worked proactively to create a global market for accounting and auditing services. In this model, the accounting profession plays an active role in the creation of global markets. The process of globalization begins with the agency of states, transnational corporations, and industry lobbies and culminates in the creation of global markets. In this view, non-market actors have deregulatory agendas, which motivate them to construct global markets to promote the dismantling of regulatory barriers to trade and investment (Arnold, 2005). The analysis in this paper will show the institutional model of globalization was in action in the Indian subcontinent enabling the entry of the multinational accounting firms into India through their global financial nexus. Further, the evidence in this paper will also show how local accounting practices, which were not sufficiently organized to face the challenges of globalization, give in to the market strategies and the combined strength of the multinational accounting firms. The evidence will also highlight the failure of the local government to protect the interests of the local accounting profession and in fact, the collusion of the local government with the multinational accounting firms to the prejudice of the Indian accounting profession.

## Methods

### *Site and Data Sources*

The field of interest in this paper is the provision of accounting services in the Indian market. This field is occupied by several organizational communities, including local accounting firms, the Big Four accounting firms, clients, and regulators such as Securities and Exchange Board of India (hereafter, SEBI) and the ICAI. The provision of accounting services in India is regulated by the ICAI and therefore these regulations can be used to demarcate the organizational community. The data sources used are interviews and archival materials. The main archival source is an extensive report about the entry of the Big Four accounting firms in the Indian market and its effects on the Indian accounting profession, in the form of a white paper published by the Chartered Accountants Action Committee For Level Playing Field. The CAAC emphasized that the white paper was published in the “public interest to inform the Indian industry, Indian finance sector, Indian government, Indian policy makers, Indian professionals, and also the general public about the correct facts of the multinational accounting firms (MAFs) and about the state of the Indian profession” (CAAC, 2002: 2). The white paper describes in detail the chronology of events from 1990 onwards about the entry of the Big Four accounting firms in the Indian market. Table 8 below provides a timeline of the events leading to and subsequent to the entry of the multinational accounting firms in the Indian market.

**Table 8. Timeline of events in the process of globalization of the Indian accounting profession.**

<b>Year</b>	<b>Event</b>
1949	The Chartered Accountants Act, 1949 was passed on 1st May. The term Chartered Accountant came to be used in place of Indian Registered Accountants.
	Chartered Accountants Act was brought into effect on 1st July. The Institute of Chartered Accountants of India is born.
1990	Foreign Exchange crisis in India and consequent probability of default on its borrowings from international markets and banks.
1991	To deal with the foreign exchange crisis, Government of India enters into a Stand-By Arrangement with the IMF.
	Structural adjustment program featuring macroeconomic stabilization and structural reforms.
1995	Reserve Bank of India grants special licenses to multinational accounting firms under Section 29 of the Foreign Exchange Regulation Act, 1947 to provide consulting services in India
1996 & 1997	Multinational Accounting firms enter into an arrangement with large local accounting firms in India creating surrogate firms to gain entry in the audit and assurance services market
2002	Birth of the Chartered Accountant Action Committee For Level Playing Field (CAAC).
	Publication of the White Paper by the CAAC to shed light on the consequence of the entry of the multinational accounting firms in the Indian market.
2006	Chartered Accountant (Amendment) Act is enacted by the Central Government of India in the Gazette of India dated 23 <sup>rd</sup> March , 2006
	Removal of restrictions on sharing of profits by between members of the ICAI and non-members.
	Permission granted to provide multi-disciplinary services by accounting firms is granted
	Prohibition of solicitation is removed
	Limited advertisement (subject to guidelines to be issued by the ICAI) is also now permitted

The paper follows a research strategy which involves a mix of data and across-method triangulation (Campbell and Fiske, 1959; Denzin 1978; Jick, 1979). The paper relied extensively on the materials contained in the white paper and other publications of the CAAC, as well as on interviews. The interviews were semi-structured and aimed at obtaining information about the

key dimensions of the intra-professional conflict from the people who were actively involved in the conflict. The interviewees comprised mainly of members of the CAAC, other members of ICAI knowledgeable about the subject, and audit partners of local and Big Four accounting firms who were affected by the entry of the multinational accounting firms. The interviews were used to obtain information which may not be effectively captured in the archival documents. The interviewees were asked to think about additional materials that might be available, including additional archival documents. The interviewees were also asked to discuss the contexts of the committees on which they served and of the reports, if any, they authored. Finally, the interviewees were asked to validate the chronology of events obtained from the archival documents. The interviews were started by describing the objective of the research and by introducing an informed consent form, which both the interviewer and the interviewee needed to sign. In particular, the interviewees were asked for permission to tape the interview, while emphasizing that complete anonymity would be provided to them and their current employing organization. Also, the interviewees were told that they would have the opportunity to subsequently verify the accuracy of the transcript and add changes that they feel might be needed to make them comfortable with what they said during the interview. Appendix B provides the occupations of the interviewees, and the time the interviews were conducted.

### *The Indian Accounting Profession*

In India, prior to 1949, the profession of accountancy in India was controlled and regulated by the government, which subsequently vested the regulatory power in the ICAI through an enactment in the parliament in 1949. The enactment was The Chartered Accountant Act of 1949 for the regulation of the profession of accounting in India. This act established a regulatory body for the Indian accounting profession in the form of the ICAI. The ICAI is



responsible for conducting examinations, development of uniform standards of practice and the strategic development of the profession. It is also responsible for licensing, certification, training, and discipline (CAAC, 2002). Table 9 below provides a detailed timeline of events related to the birth of the ICAI to the present day.

**Table 9. Timeline of events for the ICAI**

<b>Year</b>	<b>Event</b>
1857	The first ever Companies Act in India legislated.
1866	Law relating to maintenance of accounts and audit thereof introduced.
	Formal qualification as auditor now required.
1913	New Companies Act enacted.
	Books of accounts to be maintained specified.
	Formal qualification to act as auditor named. A Certificate from the local government to be held in order to act as auditor. An unrestricted Certificate entitled a person to act as auditor throughout British India. A Restricted Certificate entitled him to act as auditor only within the Province concerned and in the languages specified in the certificate.
1918	Government Diploma in Accounting (GDA) launched in Bombay. On completion of articleship of three years under an approved accountant and passing the Qualifying Examination the candidate would become eligible for the grant of an Unrestricted Certificate.
1920	The issue of Restricted Certificates discontinued.
1927	Society of Auditors founded in Madras.
1930	Register of Accountants (RA) to be maintained by the Government of India to exercise control over the members in practice. Those whose names found entry here were called Registered Accountants (RA).
1930	The Governor General in Council replaced the local government as the statutory authority to grant certificates to persons entitling them to act as auditors.
	Auditors allowed to practice throughout India.
1932	First Accountancy Board formed. The Board was to advise the Governor General in Council on matters relating to accountancy and to assist him in maintaining standards of qualification and conduct required of auditors.
1933	First examination held by the Indian Accountancy Board. GDAs exempted from taking the test.
1935	The first Final Examination was held. GDAs exempted from taking the test.
1943	GDA abolished.
1948	Expert Committee formed to examine the scheme of an autonomous association of accountants in India.
1949	The Chartered Accountants Act, 1949 was passed on 1st May. The term Chartered Accountant came to be used in place of Indian Registered Accountants.
	Chartered Accountants Act was brought into effect on 1st July. The Institute of Chartered Accountants of India is born.
1999	ICAI completed 50 years on 1st July 1999

The ICAI has its headquarters at New Delhi with five regional offices at Mumbai, Chennai, Kanpur, Kolkata, New Delhi and 98 branches spread all over the country. In addition, it

has also set up 11 chapters outside India. The total membership of the ICAI is about 115,000 and over 250,000 students are pursuing the Chartered Accountancy course. Out of the total members, nearly 70% are in practice ([www.icaai.org](http://www.icaai.org)). In addition to regulating the profession, the ICAI is a national standard setting body in India and the National Accounting Standards are given statutory recognition under various statutes. The Indian Accounting Standards have almost been harmonized with the International Accounting Standards. In addition, the ICAI also issues from time to time various guidance notes, monographs, etc. for the benefit of its members on various new issues. The ICAI also issues Auditing & Assurance Standards (AAS) which codify the audit practices to be followed by the members of the ICAI, whenever an audit is carried out. The AASs' are mandatory in nature. The ICAI has issued 30 AASs' so far which meet international benchmarks and expectations.

The affairs of the Institute are managed by the Council in accordance with the provisions of the Chartered Accountant Act of 1949 and the Chartered Accountants Regulation of 1988. The Council consists of 30 members of whom 24 are elected by the members and remaining 6 are nominated by the Central Government to represent the Comptroller and Auditor General of India, Central Board of Direct Taxes, Department of Company Affairs and other stakeholders. The Council functions through three Standing Committees and sixteen Non Standing Committees for carrying out the provisions of the Chartered Accountant Act of 1949 ([www.icaai.org](http://www.icaai.org)). The decision making process in the council is structured so that all 30 members have to consensually agree on any decision ([www.icaai.org](http://www.icaai.org)). The Indian accounting firms are subject to rules and regulations made under the Chartered Accountant Act of 1949.

One of the significant restraints that the ICAI places on its members is that Indian accounting firms cannot advertise, whether in India or abroad (CAAC, 2002). They cannot

canvass directly or indirectly for professional assignments nor can they make presentations to prospective clients. Further, Indian accounting firms cannot have non Chartered Accountants (hereafter, CAs’) as partners nor can they have any profit sharing arrangement with non CAs’ (CAAC, 2002). The Indian accounting profession is mainly comprised of small and medium sized firms, the number of firms with five or more partners being only about 375 in 2001 out of a total of 42,339 firms. The table below gives the distribution of firms by size in 2001 (CAAC, 2002).

**Table 10. Size distribution of CA firms as at 01/04/2001**

<b>No of Partners</b>	<b>No of Firms</b>
2	7161
3	2104
4	796
5	375
6	305
7	206
8	101
9	61
10	34
>10	52

## **The case of India: Entry of multinational accounting firms**

### *The Foreign Exchange crisis in 1990: Liberalization of the Indian Economy*

The age of liberalism, a period of relatively open global markets, ended after the Great Depression of the 1930s (Polanyi, 1944). In the post- World War II period, it has been held that nation states instituted Keynesian economic policies and political controls over the international movement of financial capital (Schor, 1992). In the few decades after independence in 1947, India adopted a development strategy which was one of national self-sufficiency and stressed the importance of government regulation of the economy. Cerra et al characterized it as “both inward looking and highly interventionist, consisting of import protection, complex licensing requirements, and pervasive government intervention in financial intermediation and substantial public ownership of heavy industry” (2000:3). The trade regime in India was characterized by high nominal tariffs and pervasive non-tariff barriers, including a complex import licensing system, an “actual user” policy that restricted imports by intermediaries, restrictions of certain exports and imports to the public sector, phased manufacturing programs that mandated progressive import substitution , and government purchase preferences for domestic producers (Cerra et al., 2000).The white paper reiterates this mindset in the Indian economy:

The socialist psyche was so much internalized in politics that in the late 1960s and early 1970s , anyone who disagreed with the socialist model was labeled as anti-poor and pro-rich, pro-America and even as CIA agents! Those who differed from socialist ideals were ostracized as political untouchables. With the result that, every political party was compelled to file an undertaking expressing faith in the ideology of socialism, to be registered as a political party eligible to contest elections. In fact, even the constitution of India was amended to define India as a socialist state. Even the property rights listed as unbridgeable fundamental rights were deleted and relegated to the status of mere legal rights. The effect of this is to facilitate even expropriation of property with or without adequate compensation. (CAAC, 2002: 6)

The Indian accounting profession operated in the socialist environment prevalent prior to the 1980s. Up to 1949, accounting was controlled and regulated by the Government, which

eventually vested the regulatory power in the ICAI through an enactment in the parliament in that year (CAAC, 2002). The structure of the Indian accounting profession was a reflection of the structure of the Indian economy. As the partner of a local accounting firm points out, the Monopolistic and Restrictive Trade Practices Act, 1969 (MRTP Act) effectively prohibited the formation of large companies in all the sectors of the economy and so the Indian economy was comprised of small and medium-sized companies. In a similar manner, restrictions were placed on the maximum number of partners per accounting firm. Consequently, the size of an accounting firm was limited to less than 20 partners. Further, accounting firms were also prohibited from providing multi-disciplinary range of services and from entering into profit-sharing arrangements with non-members of the ICAI. In the metropolitan centers, audit work constituted the bulk of the work of medium sized accounting firms, while taxation services were the mainstay of small sized accounting firms. The services rendered by the accounting firms included attestation services, taxation services and regulatory compliance services, which largely meant handling state regulations. The pre-dominance of audit and assurance services in the service portfolio of local accounting firms is captured in the quote below by the partner of a local accounting firm:

There was not much need for consulting services due to the nature of the market as the Indian economy was not only insulated from the global market but also had serious restraints on local market forces. On the consultancy side, which had not really grown in the absence of the market drive to the economy, handling the government, its regulations and instrumentalities for the private sector was the core part of the practice (Local firm partner).

In the restrictive regime prevalent in the Indian environment, as a partner of a Big Four firm puts it, most of the Indian companies were family-owned and as a result, much of the professional accounting work was founded on “relation-based approach as distinguished from a pure contract-based model, which is the distinctive feature of a market driven economy”. The

white paper emphasized that the Indian accounting firms operated in a protected environment, where they faced no competition from foreign accounting firms and they were also not allowed to operate in a foreign country. They did not have to adopt any strategies to maintain their monopoly over the practice of accountancy and therefore did not acquire any skills to create such strategies in the event that the market was opened which is what happened in the late 1980s and the early 1990s (CAAC, 2002).

In the 1980s and 1990s, it has been held that most of the nation states dismantled capital controls, bringing in a neoliberal period where once again capital is free to roam the world relatively unconstrained by national controls (Kapstein, 1994). This US agenda known as the “Washington Consensus” called not only for free trade and elimination of capital controls, but also for deregulation and economic restructuring. It was argued that IMF-imposed structural adjustment programs were used to coerce weak nation states such as India to abandon domestic priorities in favor of open borders and investor-friendly economies (Stiglitz, 2002).

In such a free trade environment prevalent in the world, over the period 1990-1992, public reports of India’s financial problems generated rumors of an impending foreign exchange crisis and the consequent probability of default on its borrowings from international markets and banks (Clark et al., 2003). The situation was further compounded by a variety of macroeconomic imbalances - the increase in oil prices due to the conflict in the Middle East in 1990, the reduction in remittances from Indian workers in the same region, and the reduced demand of important trading partners, as well as political uncertainty (Clark et al., 2003). To deal with the problem of shortage of foreign exchange reserves leading to non payment of external debt, the government of India requested a Stand-By Arrangement from the IMF in August 1991. The reform package from the IMF was conditional on an adjustment program featuring

macroeconomic stabilization and structural reforms. The reforms were mainly in the areas of industrial and import licenses, the financial sector, the tax system, and trade policy. On trade policy, benchmarks for the first review of the Stand-By Arrangement included a reduction in the level and dispersion of tariffs, a removal of quantitative restrictions on imported inputs and capital goods for export production, and elimination of public sector monopoly on imports of all items except petroleum, edible oils, and fertilizers and certain items earmarked for health and security reasons (Clark et al., 2003).

### *Post Liberalization: The Entry Process*

It is in the backdrop of these sweeping reforms, that I analyze the process of entry of the multinational accounting firms into India. In the process of negotiating the “bailout package” with the IMF, the multinational accounting firms observed an excellent opportunity to enter the Indian market for consulting services (CAAC, 2002). The firms entered into India as consultants through the stipulations laid out by the IMF in the reforms package offered to the Indian government. The argument was that the multinational accounting firms were needed to facilitate the free flow of the foreign direct investments into India in the liberalized regime by the multinational corporations and investment bankers, who would only be comfortable with their own consultants as advisors about the “best ways “to invest in India (CAAC, 2002:30; [www.icaai.org](http://www.icaai.org)). Faced with a foreign exchange crisis and possibility of default on its foreign loans, the Reserve Bank of India issued special licenses to the multinational accounting firms to provide consulting services in India. In the early 1990s, the Foreign Exchange Regulation Act, 1947 (FERA) was in force in India to control the outflow of foreign exchange reserves. Under the provisions of the act, foreign firms could enter the Indian market only after obtaining licenses issued by the Reserve Bank of India. The legal provision under which the multinational



accounting firms obtained licenses to operate in India is contained in Section 29 of the FERA act, which was eventually abolished in 2002.

Post liberalization, the consulting services market provided new opportunities for the Indian accounting profession in terms of providing services to the multinational companies investing in India. However, the white paper reiterates that the entry of the multinational accounting firms in the consulting services market gave them a distinct competitive edge over the local accounting firms. One of the authors of the white paper expanded on the reasons for the lack of level playing field for the local accounting firms in the new environment. According to him, while the liberalization program allowed for foreign direct investment in the other sectors of the economy, the tariff regime was not entirely dismantled which had the effect of protecting the local companies from competition by the multinational companies. The Indian currency was also devaluated in a phased manner, which allowed the local manufacturers to prepare for competition from foreign operators. However, this kind of phased liberalization was not carried out in the accounting profession. For instance, while the MRTP act was abolished allowing the formation of large Indian companies; the restriction regarding the maximum number of partners per accounting firm (20) was not removed. Thus, while the size of the local accounting firms mirrored the size of the Indian companies till the advent of the liberalization program, it was no longer the case after 1992. While the Indian companies began growing in size due to the opening up of the economy and the advantages of consolidation, the structure of the local accounting firms remained the same. As one of the interviewees who is the partner of a Big Four firm pointed out:

It was very difficult for these small local firms to meet the demands of the large scale expansions of businesses and provide quality services, which only the Big Four firms could handle! This paradigm virtually robbed the Indian accounting firms of their

competitiveness, so very crucial to take on the Big Four accounting firms in India (Big Four firm partner).

This fact and the reason for the success of the multinational accounting firms in the consulting services market is also evidenced in the reference below:

This was made possible because the MAFs managed to come to India stealthily by coining their connections in the international financial system and using the financial crisis which India faced. Thus the entire consulting services market came to be monopolized by the MAFs (CAAC, 2002: 33).

This reforms package appears to be an obvious evidence of agency and intent in the process of economic globalization. The administrative apparatus of institutions such as the IMF makes them a significant institutional actor in their own right (Arnold 2005). However, the IMF does not act on its own. The institution is heavily influenced by the interests of major nation states such as the United States and members of the European Union, and transnational firms with operational bases within the borders of the major nation states. The dominant role of the major powers within the IMF, the WTO, and the World Banks has been documented (Stiglitz, 2002). In turn, it has been held that multinational companies and industry lobbies have substantial levels of influence over the international trade agendas of their nations (Arnold, 2005). As the Held (1991) framework has argued, multinational corporations are not 'free floating agents', on the other hand, they maintain strong links with the countries of their origin (Cooper et al. 1998), and have the "potential to mobilize their national governments to influence the rules of the game to their own advantage" (Caramanis, 2002: 403).

A second and more important theme of the white paper was that the Indian accounting profession and the ICAI were not informed about the entry of the multinational accounting firms into India, nor were they aware of the mode of entry into India. The multinational accounting firms entered India through the "floodgate of reform measures initiated by the government of

India” (CAAC, 2002: 31). There was no debate about the advantages and disadvantages of the entry of the multinational accounting firms in the Indian market at any forum (CAAC, 2002; [www.icaai.org](http://www.icaai.org)). This sentiment is captured in the following reference in the white paper:

The entry was stealthy. Even ICAI was not consulted; perhaps it knew of the decision only in newspapers. While it is true that the initial ‘mistake’ could probably be attributed to the RBI and the government in as much as ICAI was not even consulted before such opening up, the leadership of the profession has also failed in its part for its apparent apathy and indifference over the continued aberration, by not raising adequate objections. (CAAC, 2002: 31)

One of the interviewees, who is a director of a surrogate firm formed by a Big Four firm and in charge of audit practice in India, was not even aware of the consulting licenses granted to the multinational accounting firms by the Reserve Bank of India. This lack of knowledge is more surprising in light of the fact that the director in question was an ex-president of the ICAI. One of the authors of the white paper confirms the silent entry of the multinational accounting firm in the Indian market and attributes it to the impulsive reaction of the Indian government to the foreign exchange crisis.

True, the ICAI was not consulted at any stage as the central government and the Reserve Bank of India (the nation’s Central Bank), which were working overtime to contain the foreign exchange crisis succumbed to the pressure of the IMF and the World Bank and the global financial pressure groups in ordering un-calibrated opening of the economy and did not deem it fit to consult the premier accounting body in any such decision making process. Opening of the consultancy field was regarded as the concomitant need to attract foreign direct investment. Since a national consensus had been built in favor of attracting foreign investment at any cost, and the opening of the consultancy sector was part of the agenda to attract foreign exchange through FDI, the opening of the consultancy sector also became integral to the emergency measures taken to correct the imbalances in the exchange regime (White Paper author).

It was in the late 1990s that some members of the ICAI started questioning the “west-centric model of globalization of the accounting profession in India” (CAAC, 2002:7). The process slowly evolved by extensive discussions, meetings and interactions within the Indian

accounting profession. The eventual result was the birth of the CAAC at Chennai, India and the publication of the white paper. The first convention of the CAAC was held on September 1, 2002, when over four hundred CAs' gathered together to discuss the implications of the entry of the multinational accounting firms in the Indian market. The members of the CAAC interacted with businessmen and policy makers as well as the media all over India and found an "amazing lack of awareness about the illicit entry of the multinational accounting firms" (CAAC, 2002:7). The members of the CAAC felt that it was necessary to shed light on the causes and consequences of the entry of the multinational accounting firms on the Indian accounting profession. The CAAC was chaired by Mr. B.S. Raghavan, a retired civil servant, who was not a CA and so it was felt that the content of the white paper would not be subject to any unintended bias. The other members of the CAAC were all CAs. It is important to note here that the ICAI was neither involved in the creation of the CAAC nor in the publication of the white paper.

Not only was the Indian accounting profession not informed about the entry of the multinational accounting firms in India, no reciprocal right was conceded to the Indian accounting firms to provide accounting services in the USA or the UK, the countries widely considered as the places of origin for the Big Four accounting firms (Caramanis, 2002). This is expected to have an adverse impact on the Indian accounting firms in the General Agreement on Trade in Services (hereafter, GATS) negotiations under the auspices of the WTO. The GATS is an existing trade agreement, whose objective is to open the borders of the WTO member nations to trade in all types of services, including accounting and auditing ([www.wto.org](http://www.wto.org)). It not only covers all types of services; it also applies to all possible modes of delivering services<sup>2</sup>. The United States has made commitments at the GATS negotiations to open its borders to all modes

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<sup>2</sup> GATS has four possible modes of delivering services, including: 1. cross-border delivery, 2. consumption abroad, 3. commercial presence, and 4. movement of natural person. For technical definitions of all four modes, see Arnold(2005)

of delivery except for Mode 4, which talks about the movement of persons where individuals from one country move temporarily to another country to deliver accounting or auditing services (WTO, GATS/SC/90, 1994). Further, the United States has also written some limitations into its GATS commitments in order to protect specific state-level accountancy laws that would otherwise be GATS illegal, such as residence requirements for CPA licenses and laws that limited ownership of accounting firms to persons licensed as accountants. This action is seen by the white paper as a “deliberate game plan of the west to maintain their control of the financial world” (CAAC, 2002:31).

In the Uruguay Round of the GATS negotiations (1986-1994), nation-states undertook limited commitments to lock in the status quo (Arnold, 2005). The effect of locking in existing levels of liberalization is that once a company undertakes commitments in the accounting sector, they are binding and cannot be altered without substantial sanctions (Arnold, 2005). Thus, the Indian accounting profession had no leverage in the negotiations in the WTO as the Big Four accounting firms had already entered the Indian market and did not have to offer any reciprocal benefits to the Indian accountants. The reason is that the GATS legal framework contains provisions that make it difficult for nations to modify or withdraw commitments once they are undertaken. The framework contains provisions to the effect that a WTO member may modify or withdraw commitments, but it has to then “compensate” any WTO member who is affected by the modification or withdrawal of the commitment (Arnold, 2005). Accordingly, India is effectively bound to the liberalization and privatization that took place during the 1980s and 1990s and the Indian government may find it very costly to reinstate restrictions on market access or policies favoring local accounting firms. For instance, when local Greek auditors attempted to regain control of the market after it had been liberalized in 1992, the United States

in collusion with the international accounting firms put intense political pressure to successfully block the attempt (Caramanis, 2002). Given the broad consensus that it may take another four or five years for the GATS to become effective (Arnold, 2005), it means that even if the Big Four accounting firms eventually give reciprocal rights to the Indian accounting firms, the Big Four accounting firms have an early entry advantage of around fifteen years over the Indian accounting firms in the Indian market.

Further, the WTO conducted a survey in 1998 to analyze the limitations faced by developing countries in the GATS negotiations (WTO, 1998). According to this survey, in most of the developing member countries, including India, incorporation as a corporate body is prohibited and partnership is the only collective form of practice allowed. This automatically puts the local accounting firms, which cannot have more than twenty partners and cannot organize themselves as a corporate entity at a disadvantage as compared to the multinational accounting firms, which don't have this restriction placed on them.

*Post Entry: Entry in the traditional auditing and assurance market*

In the post-liberalization regime, there were a host of new opportunities for the local accounting profession in the area of providing consulting services for the multinational corporations. However, the white paper argued that the local accounting firms could not fully utilize these opportunities due to the entry of the multinational accounting firms, which were given unlimited access to the market by the sweeping reforms in 1991 (CAAC, 2002). The white paper emphasized that if the entry of the MAFs was done in a phased manner; it would have given the Indian accountants ample opportunities to gain the requisite knowledge, skills and expertise to take advantage of the opportunities afforded by the trend of globalization.

The Big Four accounting firms could not directly enter the audit and assurance market due to certain provisions of the Indian Companies Act of 1956 and the Indian Chartered Accountant Act of 1949. The Chartered Accountant Act of 1949 prohibits non-CAs' from rendering audit and attestation services. Further, Section 11(2) of the Indian Companies Act of 1956 restricts the number of partners in a partnership firm to 20 partners. There are also restrictions on the acceptance of the number of audits that an Indian accounting firm may accept. The Indian Companies Act requires that the audit report and the balance sheet have to be signed by a partner of the firm in his own name and not in the name of the firm. This implies that the responsibility of the partner signing the documents is personal and unlimited.

Some of the other restrictions imposed by the ICAI on its members are that an Indian accounting firm cannot advertise, whether in India or abroad. They cannot canvass directly or indirectly for professional assignments, nor can they make presentations to prospective clients. There are rigid restrictions on the content of the websites of the accounting firms, which are laid out in the Guidance Note issued by the ICAI ([www. icai.org](http://www.icai.org)). Indian accounting firms cannot have non-CAs' as partners. Nor can the Indian CAs' or accounting firms have any profit-sharing arrangement with non-CAs'. Thus it is not possible for Indian CAs' to structure multi disciplinary practice to offer a one stop professional facility to clients.

In the light of such rigid restrictions, the Big Four accounting firms entered into an arrangement with a few large Indian accounting firms, turning them into "surrogate firms" (CAAC, 2002:34). Each of the Big Four accounting firms has more than one surrogate firm. Most of the surrogate firms are well established large Indian accounting firms in the traditional areas of audit and assurance services ([www. icai.org](http://www. icai.org)). The list of the surrogate accounting firms of the Big Four accounting firms is provided in Table 2.

This arrangement enabled the multinational accounting firms to enter the audit and assurance services market, so that the partner of the surrogate firm acted in two capacities, first as partner of the surrogate firm providing audit services and second as the director of the subsidiary of the multinational accounting firm, which was licensed to provide consulting services. Even though there were two entities, one an audit entity and another a consulting entity, both the entities shared the same premises, the same staff, the same clients and even the same website and email. With the help of the surrogate firms mentioned in the table above, the Big Four accounting firms started rendering attest and assurance services, which could only be provided by local accounting firms incorporated by CAs' licensed by the ICAI. As the consultancy arms of the surrogate firms are incorporated as corporate entities, under the Indian Companies Act, 1956, there is no prohibition for a person to be a director of the consulting entity and still remain a full time practicing partner of the surrogate firm to provide the attest functions. Thus one of the interviewees is actually both the director of the subsidiary consulting entity of a Big Four accounting firm and also a partner of the surrogate firm formed by the same Big Four accounting firm. As one of the authors of the white paper points out and the partner of a Big Four firm confirms the fact:

The partner of the local audit firm would also be the director/representative of the linked Big Four consultancy, so that one visiting card will identify him as the representative of the Big Four entity and the other visiting card will identify him as the partner of the audit firm (White paper author).

The profit sharing arrangement between the surrogate firms and the multinational accounting firms is not publicly known according to one of the authors of the white paper and an analysis of the archival documents available on the ICAI website. However, I obtained this information from the interviews conducted with the partners of the surrogate firms. The client of



the surrogate firm has the option to choose from a “menu” of firms, which are a part of the surrogate firm, for providing services. The surrogate firm then provides the services to the client using the same office space, staff and technical resources available to all the firms forming the surrogate firm. Since the multinational accounting firm cannot share profits with the local accounting firm consisting of CAs’, the multinational accounting firm charges the local accounting firm fees in the form of “technical consultancy” or “technology fees” or “training fees” , which are in turn, reimbursed by the client. Thus, in technical terms, there is no violation of the regulations contained in any of the Indian acts regulating the Indian accounting profession.

It is obvious that there is no free lunch between the concerned MAF and the surrogate firm. It is certain that there is consideration, but no one knows how the consideration is factored in. There are surmises that the consideration could be disguised in the form technical consultancy, technology fees, training fee etc. As the consultancy arms of Big 4 are in the corporate forms, as per the prevailing law, there is no bar for the same person to be a director (not whole time or managing) of the consulting private limited company, and yet remain a full time practicing professional (as a partner in a surrogate firm) to do the attest functions (White paper author).

The surrogate arrangement provided benefits to both the Big Four accounting firms as well as the few local accounting firms, which were involved in the arrangement. As the traditional areas of practice were changing with the entry of foreign direct investment, the entry of foreign institutional investors and their investments in local companies, in addition to the open partisan support of the world bodies such as the IMF and the World Bank for the multinational accounting firms, the local Indian accounting firms too “felt insecure about their capacity to retain their position, and therefore , many of them began thinking in terms of becoming their affiliates or surrogates to retain the very work they were handling and to access new work through the MAFs” (CAAC, 2002: 34). Besides gaining an entry in the traditional audit services market, the Big Four accounting firms had one more reason to enter into an arrangement with the large Indian accounting firms. The council members of the ICAI appointed by the members of

the ICAI were represented to a great degree by the partners of the surrogate firms ([www.icaai.org/members](http://www.icaai.org/members)). Although the surrogate firms constituted less than 2% of the entire population of local accounting firms, many of the ex-presidents and current presidents were partners of the surrogate firms. For instance, the partners of two of the Big Four accounting firms currently in charge of operations in India were presidents of the council of the ICAI for the years 1998 and 1993 ([www.icaai.org](http://www.icaai.org)). Therefore, the arrangement enabled the Big Four accounting firms to gain some leverage in the decision making of the ICAI.

While the Indian accounting firms are subject to the strict restrictions mentioned above such as prohibition of canvassing or advertising their services, the multinational accounting firms began to openly advertise and build their brands in their own names. These promotion activities ranged from holding cricket matches to high cost advertisements in the media to events such as instituting and giving out Business Leadership and Entrepreneur awards, in order to gain access to the high yielding corporate and financial market for professional work (CAAC, 2002). The ICAI clearly expressed its displeasure at this activity, as is evidenced from a report published in “The Chartered Accountant”, the official organ of the ICAI, which notes that:

The Government should review the alternative route of entry of accounting firms in India in the name of management consulting firm, and circumvention of the law of the land taking place directly and indirectly by performing accounting services by them (2000:16)

In 2003, a panel appointed by the central council of the ICAI recommended that the multinational accounting firms be prohibited from offering accounting and consulting services under their current names (ICAI, 2003). The panel recommended that the ICAI should not allow multinational accounting firms offering consulting or accounting services to bear a name that is similar to that of an Indian or foreign accounting firm. Acknowledging that the ICAI was not vested with jurisdiction over multinational accounting firms, the panel suggested that the ICAI

should make a representation to the department of company affairs on the adverse consequences of allowing the Big Four accounting firms to retain their names for providing management consultancy services. The panel suggested that the department of company affairs can then instruct the Registrar of Companies to prohibit the use of such names. The panel also suggested that the 'surrogate' firms should not indulge in "co-branding and attest functions directly or indirectly" (ICAI, 2003:1). It is apparent that the ICAI failed to enforce the recommendation of the panel as the Big Four accounting firms to the present date continue to provide consulting and accounting services under their own names ([www.icai.org](http://www.icai.org)).

#### *Support of the Indian Government and the Indian Financial Institutions*

To compound the woes of the already beleaguered local accounting firms, the white paper argued that the local official regulators, banks, and even governmental institutions were responsible for further undermining the efforts of the local accountants to establish some foothold in the professional market for services, by actively patronizing multinational accounting firms (CAAC, 2002). This patronage compounded by the enormous influence of the multinational accounting firms in the international arena, it is argued, adversely impacted any hopes for the Indian accountants to protect their jurisdiction of practice. The authors of the white paper unanimously emphasized this patronage of the multinational accounting firms by the local regulators, specifically the ICAI. They emphasized that while the white paper generated tremendous interest in the media and in the government, the ICAI "did nothing about it and it remained and even today, it maintains a deafening silence on the white paper" (White paper author). On the contrary, the ICAI published the vision document at around the same time as the white paper, which openly legitimated the presence of the multinational accounting firms in

India and exhorted the local accounting firms to accept this reality (ICAI, 2004). The tone in the vision document is evidence by the reference below:

The Indian Chartered Accountancy Profession must recognize the changes in Economy/Business environments, globalization of business and competitive pressures... and must recognize the path to success by adapting to the changes, knowledge management and acquiring skills to work with future environment influenced by technological and other changes. It must recognize the Institute's role as proactive, innovative and flexible and the need to be known as a World Class Advisor (ICAI, 2000: 1)

The reason for the support of the entry of the multinational accounting firms in the Indian market by the ICAI is provided by one of the authors of the white paper. According to him, the ICAI was in a "catch-22 situation". The ICAI cannot openly oppose the entry of the multinational accounting firms in the Indian market, unless it is willing to discipline the surrogate firms who are violating the rules of the ICAI, as the partners of these surrogate firms are influential members on the decision making committees of the ICAI. On the other hand, if the ICAI does not acknowledge the entry of the multinational accounting firms, it appears to be weak in the eyes of the local accounting firms who have been affected by the success of the multinational accounting firms in the audit and assurance market. So the only option available to the ICAI is to legitimize the actions of the multinational accounting firms by framing their entry as an event which is in line with the changes in the global environment and the core values of the profession.

Besides the ICAI, the local governmental authorities were providing tacit support to the multinational accounting firms to the detriment of the local accounting profession. For instance, when the divestment program of the Oil companies, which were in the public sector, was postponed by the government in 2002 for lack of political consensus, the international rating agencies immediately downgraded the investment rating of India. This rating change happened

in spite of the fact that the Indian economy was actually booming and the exports were increasing at an unprecedented pace (Topalova, 2004, IMF working paper). Further, the State Bank of India issued an advertisement inviting bids from accounting firms, in India and abroad, but the stipulation was that the size of the firm in terms of assets had to be around Rs. 500 billions. The State Bank of India is aware of the fact that there is no local accounting firm, which has assets over Rs. 500 billions. (CAAC, 2002). The patronage enjoyed by the multinational accounting firms from the Indian government is argued to range from lucrative assignments in the planning commission, advisory role disinvestments, and advisory role in implementation of new taxation structures. Table 11, which shows the list of the public sector units that, hired the multinational accounting firms as advisors provides evidence of this patronage.

**Table 11. List of Disinvestments with Foreign and Indian advisors**

Number	Name of the PSU	Advisor(Foreign)	Advisor(Indian)
1	Air-India	JP Morgan Stanley	
2	CMC Limited	KPMG	
3	Hindustan Copper	Sumitomo Bank	IDBI
4	Hindustan Insecticide		A F Ferguson(*)
5	Hindustan Organic Chemicals		A F Ferguson
6	HTL	KPMG	
7	Hindustan Zinc Ltd	BNP Paribas	
8	Indian Airlines	ANZ Grindlays	IDBI
9	IBP Limited	HSBC Securities	
10	HPCL	Warburg Dillion Read	
11	ITDC	Lazard	
12	Madras Fertilizers	Bank of America	
13	National Fertilizers Limited	Rabo Finance Limited	
14	Pradeep Phosphate Limited	Deloitte and Touche	
15	Sponge Iron India Limited		A. F. Ferguson
16	VSNL	CS First Boston	SBI Caps
17	Bharat Heavy Plates		S. B. Billimoria(*)
18	Bharat pumps		S.B. Billimoria
19	Hindustan Cable Limited		ICICI
20	Hindustan Salts		SBI Caps
21	Instrumentation Limited		IDBI
22	Jesop and Co		A. F. Ferguson
23	NEPA		SBI Caps
24	Scooters India	PWC	
25	Tungabhadra Steel		IDBI

In one of the interviews, an author of the white paper attributes this patronage to the “brand” reputation and soliciting activities of the multinational accounting firms.

The Indian banking and public sector fell prey to the attractive business models of the MAFs. To illustrate, there have been numerous instances where advertisements calling for empanelling CAs would be tailored to suit exclusively the MAFs. This was done repeatedly by some Banks and other financial Institutions when the MAFs cannot be legally present in India was overlooked by everyone including the ICAI! With the result the national firms were excluded by tender conditions. The same tender conditions could have made it obligatory for an Indian CA firm to associate itself with a MAF if experience of the kind which the MAF was only known to possess. This has happened in the case of the telecom field where the government tender used to insist that only Indian companies should bid but it

must have a foreign investor who has a certain experience in telecom operations. But here in the case of the CAs the requirement was not to promote national CA firms, but to destroy them (White paper author).

Additional evidence of lack of level playing field for the Indian accounting firms is the recent change in US regulations. The committee preparing the white paper discovered that the US regulations have been modified to stipulate that the companies listed in the US could only be audited by an audit firm registered in the US and the country where the auditors practice (CAAC, 2002). The intended effect of this regulation is to force countries such as India, which has not allowed multinational accounting firms to directly register in India, to do the same. The reason is that if India does not register the multinational accounting firms in India, then neither the multinational accounting firms nor their surrogates can certify the accounts of the Indian companies listed in the USA. Thus, there are two scenarios. Either, the surrogates of the multinational accounting firms have to be registered in the USA or the multinational accounting firms have to be registered in India. Given the reluctance of the US state bodies to grant registration to foreign accounting firms and the tremendous influence enjoyed by the multinational accounting firms with the Indian government as evidenced in this paper, it is more likely that the multinational accounting firms will be allowed to register in India.

The white paper further cites the example of a government run development financing institution, which put tremendous pressure on its borrowers to get their quarterly income statements certified by the multinational accounting firms. The assignments carried remuneration as high as Rs.15 to Rs.20 millions for four quarters. The borrowers had to follow the recommendations of the financial institution as they needed the financial support of the financial institution. The tacit support enjoyed by the multinational accounting firms from the local

government and regulating agencies in India is captured in the following reference in the white paper:

The Indian government has turned into the biggest promoter of the multinational accounting firms to the prejudice of the Indian accounting profession. The Financial Institution nominees on the boards of companies (borrowers) also began insisting on the assisted companies (borrowers) to appoint the multinational accounting firms as consultants and even as statutory auditors (CAAC, 2002: 42)

Finally, the culmination of the marginalization of the local accounting firms in India can be evidenced by the Chartered Accountant (Amendment) Act, 2006, which was notified by the Central Government of India in the Gazette of India dated 23<sup>rd</sup> march, 2006 (hereafter, the Amendment Act). Some of these changes are directly relevant to the entry of the multinational accounting firms in the Indian market. The Act, for instance, has removed the restrictions on sharing of profits or fees by a member of the ICAI with certain categories of non-members, as prescribed by the ICAI from time to time, for the purpose of rendering professional services in and out of India. Further, the Act now permits a multi-disciplinary partnership, in or outside India, with certain categories of non-members, to be prescribed, from time to time, in the Regulations. It is also now permitted to secure any professional business through certain categories of non-members, to be prescribed, from time to time, in the Regulations. The prohibition of solicitation has been relaxed in the following circumstances: - if it occurs within the fraternity; or in the event of responding to tenders or enquiries issued by various users. Limited advertisement (subject to guidelines to be issued by the Council) is also now permitted. Thus, while the act clearly legitimizes the formation of the surrogate firms by the multinational accounting firms, the local accounting firms still cannot form a partnership consisting of more than twenty partners. It is difficult to conceive



any realistic challenge that can be posed by the local accounting firms with restrictions on their size, to the formidable presence of the multinational accounting firms.

### *Theoretical Insights*

There are various theoretical insights to be derived from the evidence in this paper. First, there are very important lessons to be learned for the weak nation states in the world economy and politics just as Caramanis (2002) demonstrated in his paper from Greece's experiences during the debate on the liberalization of the statutory audit market in the 1990s. These nation states provide easy opportunities to multinational accounting firms for expansion, as the former are economically and politically too weak to resist significant international pressure (Caramanis 2002). The sheer size of the virtual financial market is hundred times the volume of real economic transactions in the world. This is evidenced by the fact that trading in derivatives which used to be in the region of \$18 billion a day in 1978 rose to over \$1 trillion a day in 1990 and to nearly \$2 trillions a day in 2002 as opposed to trading in real goods which is about \$700 millions a day in 2002(The Economic Times, 2002). The result is that this situation is likely to give enormous influence to the people who operate the financial market and the arbiters of its rules and instruments, which would be naturally the accounting industry. Therefore, no country which is not familiar with the mechanics of the global financial system can be expected to succeed in grasping the concept of globalization. This evidence in this paper emphasizes that the dangers posed by the forces of globalization to the local markets is not rooted in regressive nationalism, rather it is based on an appreciation of the fact that globalization of accounting markets has not been accompanied by a level playing field for the local accounting profession. While the multinational accounting firms have huge amount of resources at their disposal (Anisette, 2000; Chua & Poullaos, 1998), the local accounting firms are not likely to possess

either the resource base or the requisite bargaining power to compete with the multinational accounting firms. Tinker (2002) concluded that the Big Four accounting firms are an elite faction within the US accounting force, employing less than 1% of the total accounting workforce in the United States. The result is that local accountants in these weak nation-states are lured into seeking employment with the multinational accounting firms and multinational corporations with their attractive remuneration packages which cannot be offered by the local accounting firms. This would undoubtedly result in the elimination of local professional accounting firms and the domination of the accounting services market by the multinational accounting firms. Further, it has been argued that the interests of the Big Four accounting firms align more closely with those of other multinational corporations than with small, nationally based accounting firms (Arnold, 2005). This sentiment is echoed in the following quote by one of the authors of the white paper:

On the potentiality of the CAs, factors like the growing appetite of the MNCs for quality finance professional, the emerging BPO opportunities, and high salaries – aided by the narrowing space in independent ‘practice’ – have been luring the massive majority of the new generation CAs in to highly paid jobs even inside the country, with compensation levels comparable internationally. This would, no doubt, result in dwindling of Indian professional accountancy firms, automatically strengthening only the MAFs whose illegitimate presence may even become a fait accompli in law. Thus the calculated and invasion of big four into India by leveraging on their global financial network and exploiting the financial misfortunes of India in the early 1990s – without and far ahead of the safeguards, reciprocity and national treatment which the WTO offers to national professions being available to India – has eroded the potentiality of the Indian CA profession which was defenseless against such invasion (White paper author).

Second, it has been held that licenses to perform statutory audits have been historically granted to only locally established entities that are either owned or controlled by locally accredited professionals (Arnold, 2005), which is also the situation in the Indian accounting profession. Only CAS are licensed to provide audit and attestation services and the number of partners in a partnership firm is restricted to 20. These rules led to the growth of a small industry

of sole proprietorships and partnerships and the organization of the Indian accounting profession as an autonomous self-governing guild. The evidence in this paper shows these national regulations are being increasingly dismantled or superseded by the practices of the Big Four accounting firms. The result is that small and medium-sized accounting firms are likely to become vulnerable to consolidation by large professional service conglomerates and independent practitioners are likely to be swept into the corporate workforce.

Third, the only defense which nation-states appear to have to counter the forces of globalization is to strengthen and galvanize the national accounting profession, not only at the local level, but also at a global level to protect and advance the larger national interest. It has been argued that the main responsibility for this task lies in the hands of the local professional associations such as the ICAI (Willmott, 1986). Greenwood et al. (2002) concluded that the role of professional associations is that of conservatism blended with reform. While these associations are responsible for the monitoring of prevailing institutional norms, they also have an added responsibility to protecting the interests of its members from external market pressures. The professional associations in post colonial societies, however, present a different picture. Johnson (1973) showed how the historical development of professions in the post colonial societies differed fundamentally from the western world. His research argued that rather than developing as autonomous, self-governing guilds, the professions in post-colonial societies have been and continue to be subject to different forms of social and occupational control from metropolitan centers, including that exercised by major British accountancy associations and more recently the US accountancy industry. Subsequent research has found patterns of unequal exchange from Anglo-American influence over professional accountancy in weak nation states such as South Africa, Trinidad and Tobago, and Greece (Annisette, 2000; Caramanis, 2002;

Chua and Poullaos, 1998, 2002). This was evidenced by the weak response of the ICAI to the entry of the multinational firms into India. The ICAI was completely ignorant of the entry of the multinational accounting firms in India and found out about the same in the newspapers. Even after the entry of the multinational accounting firms, the ICAI made an unsuccessful attempt to prohibit the multinational accounting firms from providing services using their own names. The reluctance of the ICAI to put up a fight is evidenced in this particular reference in the white paper:

The ICAI, which does not normally get into controversies and is in fact a mechanism to discipline the profession rather than a mechanism to fight for, defend and protect the profession ....The ICAI is also not structured to fight evil as it is a gentlemen's institution, not capable of handling the unequal war forced on the profession by the entry of multinational accounting firms.... (2002: 35).

This finding is consistent with the observations of Abel, who observed that “they (professional associations) have tended to be reactionary forces rather than professive, dedicated to preserving traditional entitlements and characteristics” (1989:131). Dacin (1997) also drew attention to the ebb and flow of macro institutional pressures. In the present case, there was substantial presence of market pressures precipitated by the foreign exchange crisis and the ICAI could have been influenced by these pressures. The rationale for the weak resistance could be thus that market pressures outweighed institutional pressures, thus limiting the ability of the ICAI's to resist the change.

Fourth, the patronage of the multinational accounting firms by the local governments and the regulators is another finding of this paper. One would have expected the Indian government to ally itself with the local accountants and the ICAI in the fight for jurisdiction in the accounting and consulting industry. While it is evident that the foreign exchange crisis in 1991 and the subsequent structural reforms arrangement led the Indian Government to authorize the

entry of the multinational accounting firms in India, the continuous and relentless patronage of the multinational accounting firms by the government as well as public sector units such as the Oil companies and the nationalized banks begs explanation. The white paper attributes this patronage to the “post-colonial hangover” effect, which basically implies that post colonial societies have a tendency to associate the work product of all western societies with higher quality and branding. Another reason forwarded by one of the authors of the white paper is that hiring the multinational accounting firms provides legitimacy to the activities of the governmental institutions, which could otherwise be questioned by any other local accounting firms. In other words, local accounting firms would be hesitant to attest certain activities of the governmental organizations due to fear of legal liability. The same activities attested by the multinational accounting firms would not attract scrutiny due to the “brand” reputation of the multinational accounting firms in the global market.

The providers of FDI, private equity and fund manager and others in the west insist on the engagement of the MAFs by the Indian corporate sector. Also the government and public sector companies and banks and financial institutions in India, which have any dealing with the global financial institutions including IMF, World Bank and other global financial and commercial institutions, are also forced to engage the MAFs in India. One important reason is that should anything were to go wrong, no one would dare to question them. Secondly, their surrogate arms were always there to attest inconvenient arrangements, which a normal Indian CA would not attest (White paper author).

### **Concluding Remarks**

The major purpose of this paper has been to examine the interconnections of international politics and national realities affecting the globalization of the accounting profession in a weak nation state such as India. The paper has examined a particular episode in the intra-professional conflict over the jurisdiction of accounting services in India caused by the entry of the multinational accounting firms in India. The event of globalization has been often framed as involving choices between competing dualities: nationalism versus internationalism, national

sovereignty versus global citizenship, and unilateralism versus multilateralism. The evidence in this paper however raises the question of whether the interests and objectives of the agents who are constructing global markets through market expansion are compatible with broader societal interests. Specifically, the lack of level playing field for the local accounting firms in India due to the actions of international economic institutions and the multinational accounting firms threatens to undermine the development and growth of the local accounting profession in India. Internal liberalization in the accounting services market ahead of opening the market to multinational accounting firms would have prepared the local accounting firms for global competition. While internal liberalization could at least commence in the rest of the sectors of the Indian economy, such as the manufacturing sector where the tariff regime was not completely abolished and the rupee was devaluated in a phased manner, the accounting sector has not been liberalized to the present day, even ten years after the Big Four accounting firms have entrenched themselves in the national market.

These events have significance for researchers who are attempting to understand how globalization will transform professional services markets in developing economies. There are two strong themes forwarded by Hirst and Thompson (1995) which are supported by the events in this paper. First, the functions of the nation state tend to be reduced to distributing, rendering accountable and legitimizing powers of governance upwards to the international level and downwards to regional and other sub-national agencies and organized interest groups. Second, in this era of globalization, international economic institutions and multinational firms backed by major nation states play a pivotal role, while the authority and sovereignty of lesser states such as India may be continuously challenged and negotiated. Further, the role of professional associations in such a globalized environment remains invariable: the protection of the self-

interest of the most dominant members (Willmott, 1986). This is evidenced by the passage of the Chartered Accountant (Amendment) Act favoring the interests of the surrogate firms wielding a disproportionate amount of power in the ICAI. Inward looking professional associations, particularly in weaker nation-states, that due to historical reasons or by mistaken policy have failed to integrate with the dominant global system will find it increasingly difficult to survive in the long run (Caramanis, 2002).

There are many lessons to be learned from the liberalization of the Indian economy and the consequent entry of the multinational accounting firms in the Indian market for weak nation-states such as India. First, as Caramanis (2002) points out these countries provide huge opportunities to big international accounting firms for expansion and second, they are economically and politically too weak to resist significant international pressure (Garrod & McLeay, 1996). The realignment of power structures takes place on the Anglo-American free market model and therefore favors the Big Four accounting firms (Caramanis, 2002). It is therefore important for these weak nation-states to be prepared for the expansionist activities of the multinational accounting firms before these firms gain a strong foothold in the local accounting services market. Thus, national governments need to know as much about the corporate histories of major private international businesses, as they traditionally wished to know about rival states in the inter-state system (Strange, 1987). Also, professional associations in these weak nation-states have to break free from the post-colonial control of the metropolitan centers such as the UK and the USA and act to protect the interests of the local accounting actors to provide them a level playing field against the multinational accounting firms. The influence of international forces on the development of local professions has been documented in accounting academic research (Chua & Poulas, 1993; Cooper et al., 1998; Sikka & Wilmott, 1995). The

move for international harmonisation of accounting and auditing practices has generated an increasing interest in this area.

Finally, this paper has also challenged the argument forwarded by proponents of 'globalization' that global markets are the result of inevitable and natural market forces. In fact, this analysis enforces the theory of institutional globalization (Arnold, 2002), which states that transnational institutional forces work proactively to create global markets to the detriment of the weak nation states.



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## **CHAPTER FOUR: STUDY THREE: ENTRY OF THE MULTINATIONAL ACCOUNTING FIRMS IN INDIA: AN INSTITUTIONAL PERSPECTIVE**

### **Introduction**

*The ICAI, which does not normally get into controversies and is in fact a mechanism to discipline the profession rather than a mechanism to fight for, defend and protect the profession ....The ICAI is also not structured to fight evil as it is a gentlemen's institution, not capable of handling the unequal war forced on the profession by the entry of multinational accounting firms.... (CAAC: 2002: 35).*

Institutional theory represents one of the more robust sociological perspectives within organizational theory (Perrow, 2002). Dougherty pointed out that the theory contains “an excellent basis”(1994:108) for an account of change, first, by providing a convincing definition of radical(as opposed to convergent) change, and second, by describing the contextual dynamics that precipitate the need for organizational adaptation( Leblebici, Salancik, Copay, & King, 1991; Oliver, 1991). New institutionalism is, however, different from old institutional theory (Dimaggio and Powell, 1983). Under the old approach, issues of influence, coalitions, and competing values were central, along with power and informal structures (Clark, 1956; Selznick, 1949). This focus contrasts with new institutionalism with its emphasis on legitimacy, the embeddedness of organizational fields, and the centrality of classification, routines, scripts, and schema (Dimaggio & Powell, 1983; Meyer and Rowan, 1977). Organizational field is a concept which is central to institutional theory and represents an intermediate level between organization and society (Greenwood et al., forthcoming). It is actively involved in the processes by which socially constructed expectations and practices become disseminated and reproduced (Scott, 1994). While there have been a lot of studies focusing on the effects of change within a

organizational field, little is known about the way in which institutionalized practices change within an organizational field (Greenwood et al., 2002).

The present paper is a case study of a profession that underwent major change over a 15 year period. The setting is the accounting profession in India from 1990 to 2005. During this period, the Indian accounting profession underwent major changes both in terms of its market structure and jurisdiction. The change was precipitated by the foreign exchange crisis that almost turned the country bankrupt in 1991. To deal with the shortage of foreign exchange reserves leading to non payment of external debt, the government of India requested a Stand-By Arrangement from the International Monetary Fund (hereafter, IMF) in August 1991 (Clark et al., 2003). One of the stipulations of the Stand-By Arrangement was that the multinational accounting firms<sup>3</sup>, essentially the Big Four accounting firms, be allowed to provide consulting services in India (Chartered Accountants Action Committee For Level Playing Field (hereafter, CAAC), 2002). Consequently, the Reserve Bank of India issued special licenses to the multinational accounting firms authorizing them to provide consulting services in India. Significantly, the Institute of Chartered Accountants of India (hereafter, ICAI) was completely unaware of the licenses granted to the multinational accounting firms by the Reserve Bank of India to enter the Indian market (CAAC, 2002). The case study is thus an account of the change in the organizational field of the Indian accounting profession caused by the entry of the multinational accounting firms from 1990 to 2005. Specifically, I intend to understand the change in the accounting field from a social constructionist perspective using the neoinstitutional model of nonisomorphic change put forward by Greenwood et al. (2002). It is important to mention here that change cannot be treated as if it has a discrete beginning and ending (Pettigrew,

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<sup>3</sup> The terms “multinational accounting firms” and “Big Four accounting firms” refer to the same constituents and therefore are used interchangeably throughout the paper.

1987). So, the change examined in this paper in the Indian accounting profession may not sequentially follow all the stages of the model of neoinstitutional change.

This paper will examine how the entry occurred in a highly institutionalized setting and how the local profession and specifically the regulatory agency theorized and legitimated the change to themselves. The organizational field of the Indian accounting profession is a complex one, involving the regulatory agencies, the ICAI, the Indian government, the local accounting firms, the Big Four accounting firms and the Indian companies. Greenwood et al. call for “further studies in different settings to help specify the generalizability of their findings” (2002:75). This paper is a first attempt to understand change through all the stages of the institutional change model, beginning with a precipitating jolt leading into the processes of deinstitutionalization and preinstitutionalization and ending with understanding the process of theorizing the change and diffusing the change by compellingly presenting the new ideas as more appropriate than existing practices. This paper attempts to reinforce the view that professional associations are not only concerned with preserving the existing prescriptions but also play an important role in legitimating the change through a process of discourse in the field. This discourse enables the change to be resisted, debated, and eventually accepted.

The remainder of the paper is structured as follows. The next section outlines the theoretical constructs used in the paper and the nature of the Indian accounting profession, followed by a description of the methods and the data sources in the next section. Section IV presents the case study of the change in the Indian accounting profession in the past 15 years from 1990 to 2005, and the final section summarizes the conclusions of the study.

## Theoretical framework

### *Organizational field*

Scott defined an organizational field as a “community of organizations that partakes of a common meaning system and whose participants interact more frequently and fatefully with one another than with actors outside the field” (1995: 56). Organizational fields are formed through ‘institutional logics’ (Friedland and Alford, 1991), i.e. socially constructed rules, norms and beliefs constituting field membership, role identities and patterns of appropriate conduct. Logics conveyed through regulatory, normative and cognitive processes, shape how actors interpret reality and define the scope of socially legitimate conduct (Greenwood et al., forthcoming). The advantage of focusing upon the organizational field, rather than the individual organization is that doing so draws attention to the effects of social and technical influences on communities of organizations. Also, institutional accounts of field level processes enable us to understand the role of structuration (Greenwood et al., forthcoming). That is, organizations within a field are not only constrained by institutional structures, but, through their behaviors, act out and reproduce those structures. The result is that organizations dynamically respond to institutionalized expectations and, in so doing, amplify and elaborate them. In mature fields, therefore, organizations get progressively locked into prevailing practices.

Within a mature field, the boundaries of professional communities may be implicitly contested, but still may give the appearance of stability in the field. During these phases, practices are reproduced by regulatory and interactive processes (Greenwood et al., 2002). The appearance of stability is misleading, as fields should be seen “not as static but evolving” (Sahlin-Anderson, 1996). Fields may even “resemble institutional war” (Hoffman, 1999:352).

### *The Neo Institutional Model of Change*

The model of nonisomorphic change distilled from the change literature by Greenwood et al. (2002) is presented in Figure 1. In this model, stage 1 refers to the dynamics that precipitate change in an organizational field. These dynamics may arise from outside the field, as destabilizing “jolts” (Meyer, 1982; Meyer, Brooks & Goes, 1990) or can also arise from endogenous sources (Seo and Creed, 2002). These jolts destabilize established practices and may take the form of social upheaval (Zucker, 1986), technological disruptions, competitive discontinuities, or regulatory change (Fox Wolfgramm, Boal & Hunt, 1998; Lounsbury, 1999; Powell, 1991). These changes precipitate (stage II) the entry of new players (Thornton, 1995), the ascendance of existing actors (Scott, Mendel, & Pollack, forthcoming), or local entrepreneurship (Dimaggio, 1988; Lawrence, 1999; Leblebici, Salancik, Copay, & King, 1991; Suddaby & Greenwood, 1999). Their effect is to disturb the socially constructed field-level consensus by introducing new ideas. Hoffman (1999) described fields as populations of

-----Insert Figure 1 here-----

organizations that, though connected and influenced by overarching logics, nevertheless subscribe to different values and beliefs. Therefore, at any moment, fields contain tensions between dominant and latent logics ‘that may lie within the individual populations that inhabit the field’ (Hoffman, 1999:365). Change, thus, occurs ‘in the wake of triggering events that cause a reconfiguration of field membership and/or interaction pattern’ (1999: 351).

The next stage (Stage III) was referred to by Tolbert and Zucker (1996) as that of preinstitutionalization, in which organizations innovate independently, seeking technically viable solutions to locally perceived problems. Initially, most researchers focused upon exogenous sources of disruption because institutions are regarded as enduring and hegemonic (Greenwood et al., forthcoming). So change was expected to arise from entrants ‘transposing’ ideas from one



field to another (Sewell, 1992). This explanation suggests that peripheral organizations are more likely to innovate because they are less embedded and less privileged. Organizations at the field's center, on the other hand, are more socialized, better advantaged, and thus more resistant to change (Hirsch, 1986; Galaskiewicz & Wasserman, 1989; Davis, 1991). The point to remember is that fields are never static as they are vulnerable to ideas entering from neighboring fields and to the entrepreneurial motivations of imperfectly embedded organizations (Lawrence, Hardy, & Phillips, 2002). Change is also possible in mature fields due to inner tensions, but the likelihood of change is different across fields. Some fields are more open to new ideas as their boundaries are 'permeable' (Greenwood and Hinings, 1996). Fields also differ from each other in the degree to which they have "clearly legitimated organizational templates combined with highly articulated mechanisms (the state, professional associations, regulatory agencies) for transmitting those templates to organizations..." (Greenwood and Hinings, 1996: 1029). The more complex and elaborate these templates and the stronger the mechanisms for deploying them, the more resistant the field will be to change (Greenwood et al., forthcoming).

Preinstitutionalization is followed by theorization, which refers to the conversion of ideas into compelling formats (Strang & Meyer, 1993) and is essential for granting legitimacy to the new format. Tolbert and Zucker (1996) argued that theorization involves two major tasks: specification of a general organizational failing, in order to challenge the adequacy of existing arrangements; and justification of the new organizational form as a widely appropriate solution. Prior research has examined the roles of different theorizing agents, such as management consultants (Abrahamson, 1991; Sahlin-Anderson & Engwall, 2002), the media (Davis et al., 1994; Rao et al., 2003) and professional associations (Greenwood et al., 2002). Also, cultural symbols and language have been shown to help promote or oppose existing and nascent

templates (Greenwood et al., 2002; Covaleski et al., 2003; Suddaby and Greenwood, 2005). In some cases, transorganizational structures such as professional associations increase mutual awareness and contribute towards legitimation (Greenwood et al., 2002).

Diffusion follows successful theorization and refers to the “objectification” of innovations by creating a social consensus concerning their pragmatic value (Suchman, 1995), and thus they diffuse even further (Tolbert and Zucker, 1996). There are various patterns and mechanisms by which ideas are transported within organizational communities. Lounsbury (2001) suggests that organizations of similar status respond in similar fashion, whereas Kraatz and Zazac (1996) point to the influences of local market forces. In general, groups which are not satisfied with how their interests are accommodated will favor change. The resolutions of contested values will depend upon how well groups can successfully appeal to, and draw upon, wider institutional and market forces (Greenwood et al., forthcoming).

While there have been many studies examining each of the stages of the model in different settings of change, no study has attempted to examine change in an organizational field through the lenses of all the stages of the neo institutional model of change. This paper intends to address this gap by examining the change in the Indian accounting profession over a 15 year period through a neo institutional perspective of nonisomorphic change.

Professional associations are important because they are arenas through which organizations within a professional field interact and collectively represent themselves to themselves (Greenwood et al., 2002). These interactions help define guidelines of reasonable conduct and membership. Specifically, associations enable the delineating of the domain of a profession that is what the members can do and who can do it. Second, professional associations act as the means whereby communities represent themselves to others in the field. Finally, the

professional associations can play an important role in “monitoring compliance with normatively and coercively sanctioned expectations” (Greenwood et al, 2002: 62). According to institutional theory, collective beliefs once established become taken-for-granted and then are reproduced through processes such as training and education, hiring and certification, and ceremonies of celebration. Professional associations are very active in these processes (Ruef & Scott, 1998) and therefore, “define or enforce” (Oliver, 1997: 102) such beliefs. The first two roles described above: collective representation, both internally and externally, could be in defense of the status quo or an attempt to legitimate change (Greenwood et al., 2002). This paper extends the insights offered by Greenwood et al. (2002) into these multiple roles played by professional associations by highlighting the role played by the ICAI in the change undergone by the Indian accounting profession from 1990 to 2005.

## **Methods**

### *Sites and Data Sources*

The field of interest in this paper is the provision of accounting services in the Indian market. This field is occupied by several organizational communities, including local accounting firms, the Big Four accounting firms, clients, and regulators such as Securities and Exchange Board of India (hereafter, SEBI) and the ICAI. The provision of accounting services in India is regulated by the ICAI and therefore these regulations can be used to demarcate the organizational community. The data sources used are archival documents and semi-structured interviews.

The main source is an extensive report about the entry of the Big Four accounting firms in the Indian market and its effects on the Indian accounting profession, in the form of a white paper published by the CAAC. The CAAC published the white paper in the “public interest to

inform the Indian industry, Indian finance sector, Indian government , Indian policy makers, Indian professionals , and also the general public about the correct facts of the multinational accounting firms (MAFs) and about the state of the Indian profession” (CAAC, 2002: 2). The white paper describes in detail the chronology of events from 1990 onwards about the entry of the Big Four accounting firms in the Indian market. Table 8 (pp.53) provides a timeline of the events leading to and consequent to the entry of the Big Four accounting firms in the Indian market.

In the late 1990s, some members of the ICAI started questioning the “west-centric model of globalization of the accounting profession in India” (CAAC, 2002:7). The process slowly evolved by extensive discussions, meetings and interactions within the Indian accounting profession. The eventual result was the birth of the CAAC at Chennai, India and the publication of the white paper. The first convention of the CAAC was held on September 1, 2002, when over four hundred Chartered Accountants (hereafter, CAs’) gathered together to discuss the implications of the entry of the multinational accounting firms in the Indian market. The members of the CAAC interacted with businessmen and policy makers as well as the media all over India and found an “amazing lack of awareness about the illicit entry of the multinational accounting firms” (CAAC, 2002:7). The members of the CAAC felt that it was necessary to shed light on the causes and consequences of the entry of the multinational accounting firms on the Indian accounting profession. The CAAC was chaired by Mr. B.S. Raghavan, a retired civil servant, who was not a CA and so it was felt that the content of the white paper would not be subject to any unintended bias. The other members of the CAAC were all CAS. It is important to note here that the ICAI was neither involved in the creation of the CAAC nor in the publication of the white paper.

The research strategy adopted in this paper will begin with the white paper and will be supplemented by all the annual reports, press releases and annual president messages of the ICAI from 1990 to 2005. Other material consulted was the vision statement, which was published by the ICAI to lay out the “mission, vision and core values of the profession and repositioning the Institute and the profession of CAs’ in this century” (ICAI, 2000:1). The entry of the Big Four accounting firms will be then examined in detail by consulting the materials. Appendix A provides a comprehensive list of all the authoritative archival sources used in the paper.

The data will be analyzed as follows: First, I will read the annual reports and the white paper to gain a chronology of key events such as the timing of the foreign exchange crisis, the reform package constituted by the IMF, and the entry of the Big Four accounting firms. Once the chronology of events is established, the supplemental materials such as the vision statement and the annual president messages and other ICAI reports will also be analyzed. Then, I will read the data bank; identify all the text segments<sup>4</sup> that discussed the entry of the Big Four accounting firms in the Indian market. The interpretation of what constitutes discussion of the entry of the Big Four accounting firms will be liberal in order to maximize the possibility of capturing all relevant passages. The text segments will then be analyzed, using a process Gephardt labeled “expansion analysis” describing it as a conceptual interpretation of the hidden meanings and features of texts” (1993:1468). . Semi-structured interviews were conducted with the key constituents in the organizational field, comprising mainly of members of the CAAC, other members of ICAI knowledgeable about the subject, and audit partners of local and Big Four accounting firms who were affected by the entry of the multinational accounting firms. The interviews were used to obtain information which may not be effectively captured in the archival

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<sup>4</sup> A text segment consists of two to three sentences that contain one or more key phrases. The length of the segment is determined by the need to include sufficient context to provide understanding of how the phrase or phrases is or are being used (Greenwood et al., 2002).

documents. The interviewees were asked to think about additional materials that might be available, including additional archival documents. The interviewees were also asked to discuss the contexts of the committees on which they served and of the reports, if any, they authored. Finally, the interviewees were asked to validate the chronology of events obtained from the archival documents. Appendix B provides the background of the interviewees, and the time the interviews were conducted.

### *The Indian Accounting Profession*

In India, prior to 1949, the profession of accountancy in India was controlled and regulated by the government, which subsequently vested the regulatory power in the ICAI through an enactment in the parliament in 1949. The enactment was The Chartered Accountant Act of 1949. This act established a regulatory body for the Indian accounting profession in the form of the ICAI. The ICAI is responsible for conducting examinations, development of uniform standards of practice and the strategic development of the profession. It is also responsible for licensing, certification, training, and discipline ([www.icai.org](http://www.icai.org)). Table 9 (pp. 56) provides a detailed timeline of events related to the birth of the ICAI to the present day.

The ICAI has its headquarters at New Delhi with five regional offices at Mumbai, Chennai, Kanpur, Kolkata, New Delhi and 98 branches spread all over the country. In addition, it has set up 11 chapters outside of India. The total membership of the ICAI is about 115,000 and over 250,000 students are pursuing the Chartered Accountancy course. Out of the total members, nearly 70% are in practice ([www.icai.org](http://www.icai.org)). In addition to regulating the profession, the ICAI is a national standard setting body in India and the National Accounting Standards are given statutory recognition under various statutes. The Indian Accounting Standards have almost been harmonized with the International Accounting Standards. In addition, the ICAI also issues from

time to time various guidance notes, monographs, etc. for the benefit of its members on various new issues. The ICAI also issues Auditing & Assurance Standards (AAS) which codify the audit practices to be followed by the members of the ICAI, whenever an audit is carried out. The AASs' are mandatory in nature. The ICAI has issued 30 AASs' so far which meet international benchmarks and expectations.

The affairs of the Institute are managed by the Council in accordance with the provisions of the Chartered Accountant Act of 1949 and the Chartered Accountants Regulation of 1988. The Council consists of 30 members of whom 24 are elected by the members and remaining 6 are nominated by the Central Government to represent the Comptroller and Auditor General of India, Central Board of Direct Taxes, Department of Company Affairs and other stakeholders. The Council functions through 3 Standing Committees and 16 Non Standing Committees for carrying out the provisions of the Chartered Accountant Act of 1949 ([www.icaai.org](http://www.icaai.org)). The decision making process in the council is structured so that all the 30 members have to consensually agree on the decision ([www.icaai.org](http://www.icaai.org)). The Indian accounting firms are subject to rules and regulation made under the Chartered Accountant Act of 1949. One of the significant restraints that the ICAI places on its members is that Indian accounting firms cannot advertise, whether in India or abroad (CAAC, 2002). They cannot canvass directly or indirectly for professional assignments nor can they make presentations to prospective clients. Further, Indian accounting firms cannot have non CAS as partners nor can they have any profit sharing arrangement with non CAs' (CAAC, 2002).

The Indian accounting profession mainly consists of small and medium sized firms, the number of firms with 5 or more partners being only about 375 in 2001 out of a total of 42,339 firms. Table 10 (pp. 58) gives the distribution of firms by size in 2001 (CAAC, 2002).

## The Case Study

The model of change provided in Figure 1 will be used in this section to examine the change in the Indian accounting profession from 1990 to 2005. Although I present the change in the organizational field of the Indian accounting profession sequentially as per institutional theory, it is important to reiterate that more than one of these stages could be overlapping during the process of change. In other words, change cannot be treated as though it has a discrete beginning and ending (Pettigrew, 1987), and therefore emphasis should be more on *changing* and less on *change*. For instance, it is possible that as constituents within an organizational field are engaged in innovations during the stage of preinstitutionalization, there is some degree of theorization already in progress whereby new organizational forms are gaining legitimacy through the discourses initiated by professional associations.

### *Precipitating Jolts and Deinstitutionalization: The Foreign Exchange Crisis (1990)*

The age of liberalism, a period of relatively open global markets, ended after the Great Depression of the 1930s (Polanyi, 1944). In the post-World War II period, it was observed that many nation states instituted Keynesian economic policies and political controls over the international movement of financial capital (Schor, 1992). In the few decades after independence in 1947, India adopted a development strategy which was one of national self-sufficiency and stressed the importance of government regulation of the economy. Cerra et al. characterized it as “both inward looking and highly interventionist, consisting of import protection, complex licensing requirements, and pervasive government intervention in financial intermediation and substantial public ownership of heavy industry” (2002:3). During this time period, the trade regime in India was characterized by high nominal tariffs and pervasive non-tariff barriers, including a complex import licensing system, an “actual user” policy that restricted imports by



intermediaries, restrictions of certain exports and imports to the public sector, phased manufacturing programs that mandated progressive import substitution , and government purchase preferences for domestic producers (Cerra et al., 2002).The white paper reiterates this mindset in the Indian economy:

The socialist psyche was so much internalized in politics that in the late 1960s and early 1970s , anyone who disagreed with the socialist model was labeled as anti-poor and pro-rich, pro-America and even as CIA agents! Those who differed from socialist ideals were ostracized as political untouchables. With the result that, every political party was compelled to file an undertaking expressing faith in the ideology of socialism, to be registered as a political party eligible to contest elections. In fact, even the constitution of India was amended to define India as a socialist state. Even the property rights listed as unbridgeable fundamental rights were deleted and relegated to the status of mere legal rights. The effect of this is to facilitate even expropriation of property with or without adequate compensation. (CAAC, 2002: 6)

The Indian accounting profession operated in the socialist environment prevalent post independence in 1947. Prior to 1949, accounting was controlled and regulated by the Government, which eventually vested the regulatory power in the ICAI through an enactment in the parliament in the year 1949 (CAAC, 2002). The structure of the Indian accounting profession was a reflection of the structure of the Indian economy. As the partner of a local accounting firm points out, the Monopolistic and Restrictive Trade Practices Act, 1969 (MRTP Act) effectively prohibited the formation of large companies in all the sectors of the economy and so the Indian economy was comprised of small and medium-sized companies. In a similar manner, restrictions were placed on the maximum number of partners per accounting firm. Consequently, the size of an accounting firm was limited to less than 20 partners. Further, accounting firms were also prohibited from providing multi-disciplinary range of services and from entering into profit-sharing arrangements with non-members of the ICAI. In the metropolitan centers, audit work constituted the bulk of the work of medium sized accounting firms, while taxation services were

the mainstay of small sized accounting firms. The services rendered by the accounting firms included attestation services, taxation services and regulatory compliance services, which largely meant handling state regulations. The pre-dominance of audit and assurance services in the service portfolio of local accounting firms is captured in the quote below by the partner of a local accounting firm:

There was not much need for consulting services due to the nature of the market as the Indian economy was not only insulated from the global market but also had serious restraints on local market forces. On the consultancy side, which had not really grown in the absence of the market drive to the economy, handling the government, its regulations and instrumentalities for the private sector was the core part of the practice (Local firm partner).

In the 1980s and 1990s, it has been argued that most of the nation states dismantled the capital controls, bringing in the neoliberal period where once again capital is free to roam the world relatively unconstrained by national controls (Kapstein, 1994). This US agenda known as the “Washington Consensus” called not only for free trade and elimination of capital controls, but also for deregulation and economic restructuring. It was argued that IMF-imposed structural adjustment programs were used to coerce weak nation –states such as India to abandon domestic priorities in favor of open borders and investor-friendly economies (Stiglitz, 2002). In 1990, public reports of India’s financial problems generated rumors of an impending foreign exchange crisis and the consequent probability of default on its borrowings from international markets and banks (Clark et al., 2003). The situation was further compounded by a variety of macroeconomic imbalances - the increase in oil prices due to the conflict in the Middle East in 1990, the reduction in remittances from Indian workers in the same region, and the reduced demand of important trading partners, as well as political uncertainty (Clark et al., 2003). To deal with the problem of shortage of foreign exchange reserves leading to non payment of external debt, the

government of India requested a Stand-By Arrangement from the IMF in August 1991. The reform package from the IMF was conditional on a structural adjustment program featuring macroeconomic stabilization and structural reforms. The reforms were mainly in the areas of industrial and import licenses, the financial sector, the tax system, and trade policy. On trade policy, benchmarks for the first review of the Stand-By Arrangement included a reduction in the level and dispersion of tariffs, a removal of quantitative restrictions on imported inputs and capital goods for export production, and elimination of public sector monopoly on imports of all items except petroleum, edible oils, and fertilizers and certain items earmarked for health and security reasons (Clark et al., 2003).

In the backdrop of these sweeping reforms, it makes it easier to analyze the process of entry of the multinational accounting firms into India. In the process of negotiating the “bailout package” with the IMF, the multinational accounting firms saw an excellent opportunity to enter the Indian market for consulting services (CAAC, 2002). One of the stipulations of the reform package from the IMF was that the multinational accounting firms be allowed to provide consulting services in India. The argument was that the multinational accounting firms were needed to facilitate the free flow of the foreign direct investments into India in the liberalized regime by the multinational corporations and investment bankers, who would only be comfortable with their own consultants as advisors about the “best ways” to invest in India (CAAC, 2002; [www.icai.org](http://www.icai.org); The Economic Times, 1993). Faced with a foreign exchange crisis and possibility of default on its foreign loans, the Reserve Bank of India issued special licenses to the multinational accounting firms to provide consulting services in India. In the early 1990s, the Foreign Exchange Regulation Act of 1947 (FERA) was operating in India to control the outflow of foreign exchange reserves. Under the provisions of this act, foreign firms could enter

the Indian market only after obtaining licenses issued by the Reserve Bank of India. The legal provision under which the multinational accounting firms obtained licenses to operate in India is contained under Section 29 of the FERA act, which was eventually abolished in 2002.

Post liberalization, the consulting services market provided new opportunities for the Indian accounting profession in terms of providing services to the multinational companies investing in India. However, the white paper argues that due to the entry of the multinational accounting firms, the local accounting firms could not take advantage of these opportunities as the multinational accounting firms became competitive forces in the consulting services market.

This (entry) was made possible because the MAFs managed to come to India stealthily by coining their connections in the international financial system and using the financial crisis which India faced. Thus the entire consulting services market came to be monopolized by the MAFs (CAAC, 2002: 33).

The Indian accounting profession and the ICAI were not informed about the entry of the multinational accounting firms into India, nor were they aware of the mode of entry into India. The multinational accounting firms entered India through the “floodgate of reform measures initiated by the government of India” (CAAC, 2002: 31). There was no debate about the advantages and disadvantages of the entry of the multinational accounting firms in the Indian market at any forum (CAAC, 2002; [www.icaai.org](http://www.icaai.org)). No reciprocal right was conceded to the Indian accounting firms to provide accounting services in the western countries. This action is seen by the white paper as a “deliberate game plan of the west to maintain their control of the financial world” (CAAC, 2002:31). The reason for the lack of reciprocal privileges to the Indian accounting firms in the US market was the US position in the WTO that constitutional arrangement confers the right of regulation of corporate and accounting bodies on the States and the Federal Government has no authority over accounting regulation (Arnold, 2005). Thus, the

Federal Government would be violating the US constitution if it granted rights to foreign accounting firms to provide services in the USA.

Subsequently, after gaining a foothold in the consulting services market, the multinational accounting firms entered into an arrangement with a few local accounting firms turning them into “surrogates” (CAAC, 2002). The ICAI’s ignorance about the entry of the Big Four accounting firms and subsequent lack of any action by the Indian accounting profession is evidenced by the reference in the white paper below:

The entry was stealthy. Even ICAI was not consulted; perhaps it knew of the decision only in newspapers. While it is true that the initial ‘mistake’ could probably be attributed to the RBI and the government in as much as ICAI was not even consulted before such opening up , the leadership of the profession has also failed in its part for its apparent apathy and indifference over the continued aberration , by not raising adequate objections. (CAAC, 2002: 31)

The foreign exchange reserves crisis, the resulting liberalization program instituted by the government of India, and the eventual entry of the multinational accounting firms in the Indian market are events signaling the precipitating jolt leading to the deinstitutionalization of the organizational field of the Indian accounting profession. A few elements are noteworthy. First, the foreign exchange reserves crisis that precipitated the change in the field of the Indian accounting profession arose from outside the field in the form of a destabilizing jolt (Meyer, 1982; Meyer, Brooks, & Goes, 1990). This jolt simultaneously precipitated change in the finance, tax, and accountancy fields. Second, since the jolt originated outside the field of the accounting profession, the principal constituents of the field such as the ICAI and the local accounting firms were taken by surprise by the entry of the multinational accounting firms in the Indian market. It follows that change originating from exogenous sources can disrupt the socially constructed field level consensus without the knowledge or inputs of the constituencies of the organizational field experiencing the change. Third, the entry of the Big Four accounting firms in the Indian market

and their affiliation with the local accounting firms making them into “surrogate firms” (CAAC, 2002) clearly points to the entry of new players and the ascendance of existing players (Thornton, 1995; Thornton and Ocasio, 1999; Scott, Ruek, Mendel & Caronna, 2000), thereby changing the intellectual climate of ideas in the field of the Indian accounting profession. The fact that the ICAI was not informed about the entry of the Big Four accounting firms and the local accounting firms entered into an arrangement with the new entrants, highlights the “tensions between dominant and latent logics that may lie within the individual populations (or constituencies) that inhabit the field” (Hoffman, 1999: 365). Change is therefore precipitated by triggering events that cause a reconfiguration of field membership, evidenced by the alliance between the Indian accounting firms and the Big Four accounting firms (Hoffman, 1999). The creation of “surrogate firms” out of the local Indian accounting firms by the Big Four accounting firms will be analyzed in detail in the next stage of preinstitutionalization.

*Preinstitutionalization: Entry of the Big Four accounting firms in the Indian Market*

The Big Four accounting firms entered the Indian market in the backdrop of the reform measures initiated by the Indian government due to the foreign exchange crisis in 1991. There was no consultation process of any kind with any stakeholder about the decision to grant licenses to the Big Four accounting firms to operate in India (CAAC, 2002). Specifically, two primary stakeholders, the ICAI and the local accounting firms were not aware of the entry of the Big Four accounting firms in the Indian market. As one of the authors of the white paper pointed out in the interview, the Big Four accounting firms entered India as consulting firms and then started providing other types of services such as globally linked taxation, non-statutory attestation work and management and proprietary audit services. However, they could not provide statutory audit services due to provisions in the Indian Companies Act of 1956, which only allowed local

accounting firms to conduct statutory audits. Therefore, the Big Four accounting firms entered into an arrangement with a few large Indian accounting firms, turning them into “surrogate firms” (CAAC, 2002:34). Each of the Big Four accounting firms has more than one surrogate firm. Most of the surrogate firms are well established large Indian accounting firms in the traditional areas of audit and assurance services ([www. icaai.org](http://www.icaai.org)). The list of the surrogate accounting firms of the Big Four accounting firms is provided in Table 2 (pp.17).

This arrangement enabled the multinational accounting firms to enter the audit and assurance services market, so that the partner of the surrogate firm acted in two capacities, first as partner of the surrogate firm providing audit services and second as the director of the subsidiary of the multinational accounting firm, which was licensed to provide consulting services. Even though there were two entities, one an audit entity and another a consulting entity, both the entities shared the same premises, the same staff, the same clients and even the same website and email. With the help of the surrogate firms mentioned in the table above, the Big Four accounting firms started rendering attest and assurance services, which could only be provided by local accounting firms incorporated by CAs’ licensed by the ICAI. In a report published in the “Chartered Accountant”, the official publication of the ICAI, the Institute noted:

The Government should review the alternative route of entry of accounting firms in India in the name of management consulting firm, and circumvention of the law of the land taking place directly and indirectly by performing accounting services by them”(2000:16)

While the ICAI imposed strict restraints on the local accounting firms such as prohibition of canvassing, advertising their services, the Big Four accounting firms openly indulged in advertising and brand-building activities such as sponsoring cricket matches and high cost advertisement in the media through their surrogates (CAAC, 2002; [www.icaai.org](http://www.icaai.org)). The Big Four accounting firms managed to advertise their services as they were not directly regulated by the

ICAI and therefore the regulations which prohibited local accounting firms from advertising or soliciting clients did not apply to the Big Four accounting firms. Further, the surrogate firms were able to convince Indian companies, which had received foreign direct investment or privately placed Foreign Institutional Investors (hereafter, FII) investment or which had entered into joint venture agreements with foreign companies, to replace their statutory and internal auditors with the surrogate firms (CAAC, 2002). The argument was that doing so would enable knowledge sharing between consulting and auditing services thereby benefiting the client. In addition to gaining an entry in the traditional audit services market, the Big Four accounting firms had one more reason to enter into an arrangement with the large Indian accounting firms. The council members of the ICAI appointed by the members of the ICAI were represented to a great degree by the partners of the surrogate firms ([www.icaai.org/members](http://www.icaai.org/members)). Although the surrogate firms constituted less than 2% of the entire population of local accounting firms, many of the ex-presidents and current presidents were partners of the surrogate firms. For instance, the partners of two of the Big Four accounting firms currently in charge of operations in India were presidents of the council of the ICAI for the years 1998 and 1993 ([www.icaai.org](http://www.icaai.org)). Therefore, the arrangement enabled the Big Four accounting firms to gain some leverage in the decision making of the ICAI.

According to the neo-institutional perspective, change is expected to arise from entrants transposing ideas from one field to another (Sewell, 1992), which explains the disruption caused by the Big Four accounting firms in the Indian accounting field. First, the Big Four accounting firms expanded the jurisdiction of the Indian accounting profession by bringing the consulting services market within the scope of the Indian accounting field. This was made possible by the creation of local accounting firms into surrogate firms providing both auditing and consulting



services. Before the entry of the multinational accounting firms, the local accounting firms primarily provided only audit and assurance services (CAAC, 2002). Second, by creating surrogate firms out of the Indian accounting firms, the Big Four accounting firms managed to enter the traditional areas of audit and assurance services, without breaking the ICAI regulation which prohibits non CAs' from providing audit and assurance services. However, neo-institutional theory also portrays logics not as hegemonic, but as imperfectly diffused (Greenwood et al., forthcoming). This explanation suggests that peripheral organizations are more likely to innovate because they are less embedded and less privileged. Organizations at the field's center, on the other hand, are more socialized, better advantaged, and thus more resistant to change (Hirsch, 1986; Galaskiewicz & Wasserman, 1989; Davis, 1991; Leblebici et al., 1991; Kraatz and Zazac, 1996; Haveman & Rao, 1997; Palmer & Barber, 2001). In the present case however, the large well-established Indian accounting firms were the first innovators although they were in the most advantageous position before the entry of the Big Four accounting firms in the Indian market.

The explanation above would suggest that the smaller local accounting firms would be keener to accept the change and if possible, merge with the Big Four accounting firms as they were less embedded and less privileged than the large local accounting firms. However, the proposition that change originates from the periphery of a field is not absolute (e.g. Podolny, 1993; Greenwood et al., 2002; Sherer & Lee, 2002). In fact, Greenwood and Suddaby (2006) examined the introduction of a new organizational form by the Big Five accounting firms in the 1990s and concluded that markets and institutional forces unfold at different rates enabling larger, central organizations to outgrow their 'institutional moorings', allowing strategic choice. This argument explains the actions of the large accounting firms entering into an arrangement with the

Big Four accounting firms. First, the Big Four accounting firms had a competitive advantage over the local accounting firms in the consultancy services market in India due to their connection with the global financial institutions, investment bankers and rating agencies. Thus the large local accounting firms would benefit greatly from a relationship with the Big Four accounting firms. Second, the large local accounting firms were insecure about retaining their clients “in the traditional areas of audit and assurance services” (CAAC, 2002:34) due to the huge amount of foreign direct investment by multinationals in the Indian companies because these multinationals had strong links with the Big Four accounting firms. The global connections of the multinational accounting firms and the fear of losing ground in the traditional audit and assurance services market encouraged the local accounting firms to overcome their institutional “moorings” and to strategically align themselves with the multinational accounting firms.

*Theorization and Diffusion: The Vision Project (1998)*

The ICAI constituted a committee on Vision and Restructuring in 1998 to carry out a historic exercise of revisiting the profession and to make an attempt towards the “repositioning of the Institute and the profession of CAs’ in this century” (ICAI, 2000:1). The committee published a vision statement titled “Vision for the 21<sup>st</sup> Century” in September, 2000 for public dissemination. The objective of the vision statement was very clear. It was “to formulate strategies for the success of the profession in rapidly changing economic scenario; and to give a platform for paradigm shift and to become a total business solution provider” (ICAI, 2000:2). The tone in the vision statement is clearly different from the tone in the white paper (CAAC, 2002) and both of these documents were both published at around the same time. While the white paper was clearly anti- globalization and not in favor of the entry of the Big Four

accounting firms, the vision statement considered the trend of globalization as inevitable and, therefore, implies that the entry of the Big Four accounting firms was an unavoidable fact to be faced by the Indian accounting profession. The reason could be attributed to the fact that the CAAC committee, which published the white paper, was not constituted by the ICAI. Further, the CAAC was comprised of council members, who were not associated with the Big Four accounting firms and therefore represented the interests of the local accounting firms. The committee was comprised of retired civil servants and investigative journalists, all of whom are CAS. On the other hand, the Committee on Vision and Restructuring was formed by the ICAI and mainly comprised of members associated with the surrogate firms ([www.icaai.org](http://www.icaai.org)). The tone in the vision statement can be seen in the reference below:

The Indian Chartered Accountancy Profession must recognize the changes in Economy/Business environments, globalization of business and competitive pressures... and must recognize the path to success by adapting to the changes, knowledge management and acquiring skills to work with future environment influenced by technological and other changes. It must recognize the Institute's role as proactive, innovative and flexible and the need to be known as a World Class Advisor (ICAI, 2000: 1)

The vision statement appears to be a relatively clear expression of how the entry of the Big Four accounting firms and consequently the foray of accounting firms into consulting services came to be theorized by the association. The trend of globalization of accounting services was framed as “natural and inevitable” (ICAI, 2000:4). Moreover, the change was also framed as being beneficial to the Indian accounting profession. This is evident from the vision statement, which states that “The Vision describes a better vision for the profession than what existed before the Vision process. If the Vision were true today, non-accounting students would be more likely to pursue a career in the CA profession” (ICAI, 2000:7). More importantly, the change was described as within the scope of the “core values, services, and competencies” of the profession.

The core values, services and competencies are broad and provide flexibility (for the change) (ICAI, 2000:8)

This argument brings the change in normative alignment with the profession. Thus the theorization attempt so far did not mention any organizational failings as would be implied by institutional theory (Greenwood et al, 2002). On the other hand, the change was touted as a normal event to advance the progress of the Indian accounting profession.

It is worthwhile to note at this point that, while the white paper and the vision statement addressed the change in the Indian accounting profession and acknowledged the competitive pressures, an analysis of the regular publications such as The Chartered Accountant magazine and the President's messages on the ICAI website from 1995 to 2005 reveals that the ICAI continued its routine activities as before ([www.icai.org](http://www.icai.org)). These activities were comprised primarily of clarifications of the technical rules of accounting and professional development. There were no changes in the program of precertification education to accommodate the change in the Indian accounting environment requiring the CA to "recognize the need to expand knowledge , education and experience to provide value, communicate solutions , and enhance the attractiveness of the profession"(ICAI, 2000:10). A comparison of the syllabus for the academic year 2005-2006 with the syllabus for the academic year 1994-1995 reveals no differences in the composition of the courses except for the addition of management information technology course in the year 2005, reflecting the importance of computer technology. In other words, the routines of the institute reflected the "conservative" role played by the professional associations, which is that of "monitoring prevailing institutional norms" (Greenwood et al., 2002:62). The argument within institutional theory is that once collective beliefs develop and are established, the practices associated with them are reproduced through processes such as training and education, hiring and certification (Greenwood et al., 2002). The routines of the ICAI provide evidence of

the reproduction of these established beliefs. On the other hand, the vision statement and the white paper reflected the “reforming” role of the professional associations, which is that of “collective representation in an attempt to justify the status quo”, a role performed by the white paper, “or legitimate change”, a role performed by the vision statement (Greenwood et al., 2002:62). In other words, the white paper was playing the conservative role of protecting the jurisdictional boundaries of the Indian accounting profession as well as the conditions of membership: that is who can practice within that jurisdiction and how. On the other hand, the vision statement was playing the reforming role of legitimating change by appealing to the “core values” of the profession.

Another theme in the vision statement was that the Indian accounting profession had to extend its focus beyond offering traditional accounting services and the need to address competition from the multinational accounting firms. These arguments were framed in a subtle manner as is evidenced by these references “A broader focus beyond “Numbers” to strategic thinking will lead to increased opportunities, professional respect, and increased rewards. The profession must address marketplace pressures from competitors in compensation packages, opportunities for rewards and advancement and who are accommodating leisure, life style and culture performances”( ICAI, 2000:4).

There are three elements worth noting here. First, the stress on focusing beyond “numbers” is an attempt to justify the actions of the “surrogate” firms offering consulting services and expanding the boundaries of the Indian accounting profession. More importantly, the argument was framed as beneficial to the entire accounting profession, not just the large accounting firms “...international arena will present even greater opportunities, not just to the large accounting firms, but to individual CAS, small firms...” (ICAI, 2000:7). This is important

as it reflects an attempt by the ICAI to justify the change in a manner more likely to appeal to majority of the local accounting firms, which were small in size. Second, the “competitors” referred to appear to be the Big Four accounting firms and the “marketplace pressures” appear to be the higher compensation packages offered by the Big Four accounting firms to hire the local CAS. In other words, the local accounting firms would have to match the increased incentives offered by the Big Four accounting firms in order to attract and retain highly qualified accountants. This position is revealing as it signals an expression by the ICAI of the inevitable presence and acceptance of the entry of the Big Four accounting firms in the Indian market. However, no mention was made of the huge differences between the resources of the Big Four accounting firms and the local accounting firms.

Third, the actions of the ICAI linking “professional respect” and “increased rewards” point to the often neglected question: Is the profession a business that pursues profit, and one that shifts its activities depending on the specific form that capital accumulation takes in different places and times? (Hanlon, 1994, 1996). Robson, Willmott, Cooper, and Puxty (1994) is an extensive exploration of the ways in which British professional bodies articulated an increasingly commercial role for their members (notably in relation to selling financial services and expanding or protecting the practice and regulatory rights of British accountants), and how this interacted with their claims to be ‘professional’ and acting in the public interest. Radcliffe et al. (1994) takes the analysis further by pointing out that the UK professional bodies worked hard to construct themselves, at least discursively, as enterprising organizations. The ICAI appears to attempt the same goal by emphasizing the importance of ‘strategic thinking’ by the local accounting firms in the changing global environment. The suggestion is that the only way for the local accounting firms to survive in the globalized environment with the entry of the

multinational accounting firms is to “adopt a structure and mindset that can rapidly adapt to the changes in the profession and the business community” (ICAI, 2005:7). The vision document states:

A core skill will be change management with willingness to abandon the old and move toward the new (ICAI, 2005:7)

Another observation is that the language used to justify the change combined the need for market positioning with the rhetoric of “providing value and service” making the debate sound more professional than businesslike. Moral legitimacy was injected into the pragmatic interests of the profession which is evident from the reference below:

Expanded Knowledge, education, experience and the seamless use of technology will create more opportunities to provide value, communicate solutions, and enhance the attractiveness of the profession. (ICAI, 2000:11)

While the entire vision statement is filled with references framing change as inevitable and the metamorphosis of the accountant in to a “total business advisor”, the culmination of the endorsement for the change by the ICAI appears in stronger language in the final section of the vision statement.

The Institute’s culture needs to broaden its focus from traditional services (e.g. Assurance). To win business, the Indian CAs’ will need to provide value added services which would help business become more competitive. Industry specialization and detailed understanding of clients’ business will underpin the ability to add value. Competitors will no longer be restricted to accounting firms. Members will compete in new market against other professional disciplines and accounting designation, where CAS will be a minority (ICAI, 2000: 35)

In other words, the vision statement exhorts the local accounting firms to expand their scope of services from the traditional areas of auditing and assurance into consulting services. Further, there is a reference to the fact that the consulting services market is primarily dominated by non CAs’, thereby making CAs’ a minority constituent in the new field. This reference is

particularly revealing because before the entry of the multinational accounting firms, the local accounting firms operated in a protective environment with their only competition in the form of other accounting firms. The entry of the multinational accounting firms ushered in a new competitor in the form of consulting companies.

Additional evidence of the theorization tasks carried out by the ICAI can be found in the Rules of Merger & Demerger, formulated and finalized by the ICAI on the basis of recommendations of the Study Group on Capacity Building Measures Of CA Firms (ICAI, 2005). The purpose of these rules was to regulate affiliations of two or more accounting firms providing accounting and consulting services in the Indian market. The affiliation was defined as:

Network amongst two or more firms means an arrangement to facilitate the better functioning of the affiliate member firms in the interest of the profession and not for the acquisition of any gain. Such Network shall include the Formal Network to use the collective resources such as turnover, infrastructures, manpower, and location for execution of Professional services of one or more type (ICAI, 2005).

This affiliation would also include association with an accounting entity outside India (essentially, the multinational accounting firms) such that it results directly or indirectly in a common professional economic or beneficial interest. Further, if different local accounting firms are networked with a common multinational accounting firm, then irrespective of the presence/absence of any 'affiliate' relationship between the local accounting firms, they shall be considered part of the network (ICAI, 2005). However, registration with the institute is not mandatory. These rules provide a variety of insights. First, while the stated purpose of the rules is to provide a "level playing field for the local accounting firms by pooling together their resources to enable them to compete with the surrogate firms formed by the multinational accounting firms" (ICAI, 2005: 1) , as one of the authors of the white paper noted, the rules appear to be a clever attempt by the ICAI to legitimize the creation of the surrogate firms and an



endorsement of the multidisciplinary services provided by the surrogate firms. Second, the ICAI clearly attempts to provide moral legitimacy to the creation of the surrogate firms by stating that the “network” arrangement is meant to “facilitate the better functioning of the affiliate member firms in the interest of the profession and not for acquisition of any gain.” Third, the provision of not requiring mandatory registration of the networks with the ICAI provides an easy escape route to the surrogate firms to avoid enforcement of compliance with the rules.

Finally, one of the most significant provisions of the rules is that if one firm of the network is the statutory auditor of an entity then the networked firms or the said firm directly or indirectly should not accept the internal audit or book-keeping or such other professional assignments, which are prohibited for the statutory audit firm. While this provision will prevent networks of local accounting firms from providing consulting services to clients to whom they provide statutory audit services, it will not have any impact on the surrogate firms formed by the multinational accounting firms. The reason is that multinational accounting firms are outside the jurisdiction of the ICAI and therefore cannot face any punitive action for their activities. This provision, therefore, places the local accounting firms at a disadvantage when competing with the multinational accounting firms.

The theorization tasks carried out by the ICAI above in the form of the vision statement and the rules of merger and demerger revolved around framing of the problem and the justification of the solution. The first task was done by framing the “change” being experienced by the Indian accounting profession as “natural and “inevitable”. The Indian accounting profession has to accept and adapt to the change for the prosperity of the profession. The second task of the theorization process, which is justification of the solution, was done by combining the need for “market positioning” with the rhetoric of “adding value” and “service”. The change was

described to be in alignment with the “core values” of the profession. The benefits of the change will accrue not only to the large accounting firms but also the sole proprietors and the small accounting firms. Greenwood et al. (2002) found a similar theme in case of the Canadian accounting profession where change from purely accounting services to a multidisciplinary practice concept was justified by invoking professional values. The only difference between the Canadian field and the field discussed in the present paper is that, in the former field, there was very little explicit discussion of the functionality of the change. In other words, the multidisciplinary practice concept was justified by appealing to professional values and service and not by appealing to the functional reality of market forces. In the Indian field, the change was legitimated by moral as well as functional reasoning.

Diffusion follows successful theorization (Greenwood et al., 2002). In other words, diffusion occurs if and only if, new ideas are compellingly presented as more appropriate than existing practices. This can be achieved either by nesting and aligning new ideas within prevailing normative prescriptions, thus giving them moral legitimacy (Tolbert and Zucker, 1996), and/or by asserting their functional superiority, or pragmatic legitimacy (Suchman, 1995). In the present case, the vision statement tried both methods by appealing to the local accounting firms to respond to “marketplace pressures” accompanied by framing the change to be in alignment with the “prevailing core values of the profession”. Further, the rules of merger and demerger constituted by the ICAI attempted to assert the functional superiority of the ‘affiliate’ structure of accounting firms providing a wide range of services over the independent accounting entity providing traditional accounting and assurance services. However, as is evident from the tone of the white paper published around the same time as the vision statement, the new ideas had not yet gained social consensus concerning their pragmatic or moral value. As indicated

earlier, the reason for the same could be an unsuccessful attempt at carrying out the first step in the theorization process: framing the problem. The change was not positioned as an event to address any organizational failing as suggested by institutional theory, but as an inevitable event for the prosperity of the Indian accounting profession. The notion of “institutional war” in a field as envisaged by Hoffman (1999) is very much at play here. This fact is evident in the last section of the white paper which prescribes a “course of action” for the Indian accounting firms to counter the “threat” posed by the entry of the multinational accounting firms.

The members of the firms (local accounting firms) should not be carried away by slogans such as globalization...No further multinational accounting firms should be allowed to come in and establish business whether as consulting companies or as accounting firms....pending the outcome of the negotiation of GATS within the WTO, revoke the licenses given to these firms to operate in India (CAAC, 2002:138).

In the present setting, however, extensive changes were made to the Chartered Accountant Act, 1949 through the Chartered Accountant (Amendment) Act, 2006, which have been notified by the Central Government of India in the Gazette of India dated 23rd march , 2006 (hereafter, the Amendment Act). Some of these changes are directly relevant to the entry of the multinational accounting firms in the Indian market. The Act, for instance, has removed the restrictions on sharing of profits or fees by a member of the ICAI with certain categories of non-members, as prescribed by the ICAI from time to time, for the purpose of rendering professional services in and out of India. Further, the Act now permits a multi-disciplinary partnership, in or outside India, with certain categories of non-members, to be prescribed, from time to time by the ICAI. It is also now permitted to secure any professional business through certain categories of non-members, to be prescribed, from time to time by the ICAI. The prohibition of solicitation has been relaxed in the following circumstances: - if it occurs within the fraternity; or in the

event of responding to tenders or enquiries issued by various users. Limited advertisement (subject to guidelines to be issued by the ICAI) is also now permitted.

The new act clearly signals the objectification and institutionalization of the presence of the multinational accounting firms in the Indian market. However, the passage of the Act despite the lack of acceptance of the new ideas by all the constituents of the organizational field of the Indian accounting profession as evidenced by the white paper raises an interesting question. How can diffusion occur without successful theorization?

Hinings and Greenwood (1988) provide an explanation by pointing to the internal complexity of organizations. Building upon resource-dependence theory, they see organizations as coalitions of structurally differentiated groups. Organizations also experience contested values. The resolutions of contested values depend upon how well groups can successfully appeal to, and draw upon, wider institutional and market forces. The institutional model emphasizes the role of the institutional context, which also confers power and status upon groups, but not necessarily in a manner consistent with market forces. For instance, Greenwood et al., (2002) concluded that market conditions promoted the revenue-generating contribution of consultants within accounting firms but power remained with accountants because of regulations prohibiting non-accountants from controlling accounting firms. In the present setting, however, the passage of the act allowing non-members, essentially members of the multinational accounting firms, to enter into profit sharing arrangements with members of the ICAI, signals the transfer of power within the surrogate firms from members of the local accounting arm of the surrogate firm to the partners or members of the multinational accounting firms. As one of the authors of the white paper points out:

Now the Big Four no longer have to hide behind the guise of the local accounting firms and can openly provide audit and assurance services as long as they have one local CA as a

partner working for them. The balance of power is bound to shift (in favor of the multinational accounting firms) (White paper author)

This suggests that when the mechanisms (in this case, the ICAI and the regulatory agencies) for protecting the institutional templates within an organizational field are weak, market forces can outweigh institutional forces resulting in new organizational structures as dictated by the market forces.

## **Discussion and Conclusion**

### *Role of professional associations in the process of change*

Professional associations have been argued to perform three roles: the reproduction of prevailing logics through repetitive routines, hosting intraprofessional discourse, and representing the profession to outsiders (Greenwood et al, 2002). The first role has been argued to be a more conservative role, whereas the last two roles may not have conservative outcomes. For instance in the current setting, the ICAI's routines reinforced and reproduced the prevailing logic of action (first role), while the same association hosted and narrated the debate over which the creation of surrogate firms by the multinational accounting firms came to be legitimated and consulting services and activities were included within the jurisdiction of accounting.

In the current setting, similar to Greenwood et al. (2002), the ICAI did not initiate the change. The change was precipitated by the jurisdictional and organizational movements of the profession's largest firms, specifically the large local accounting firms which formed a surrogate arrangement with the multinational accounting firms. The ICAI merely responded to these actions of the firms. This pattern is consistent with the observations of Greenwood et al. (2002) who argued that the large firms had three reasons to act as institutional entrepreneurs. First, these firms were less captured by the prevailing routines. Second, they were attuned to the emerging

opportunities presented by the entry of the multinational accounting firms with their strong connections in the global financial system. Third, they wielded a disproportionate amount of power in the profession through representation in the ICAI and therefore were better equipped to resist traditional practices. The important role played by the ICAI was to frame the entrepreneurial movement in terms that would nullify any opposition or resistance by the other constituents within the organizational field. In the present setting however, there was sharp resistance as is evidenced by the tone of the white paper and the opposition to the entry of the multinational accounting firms in the Indian market. Although the ICAI attempted to provide moral and functional reasons to legitimate the entry of the multinational accounting firms and the evolution of a “total business provider” replacing the traditional CA , it would be naïve to infer from the evidence in this paper that the legitimating activities of the ICAI succeeded in completely nullifying the opposition to the change. So the question arises: Why did the ICAI seek to legitimize the change in spite of the strong opposition to the change from various constituents of the organizational field?

It has been argued that increasing pressure of market forces over a long period of time, in this case over eight years, can alter the balance between institutional forces and market forces in favor of the latter, thus forcing the ICAI to play its reforming role and legitimate the change (Greenwood et al., forthcoming). However, the evidence in this paper suggests two more reasons. First, as explained earlier, the larger firms which were involved in the surrogate arrangement had the political resources to influence the actions of the ICAI. Second, the ICAI was placed in a position whereby its own legitimacy was endangered. The reason is that the multinational accounting firms who created the surrogate firms and expanded the boundaries of the Indian accounting profession were not within the jurisdiction of the ICAI. So the ICAI could not resist

or oppose any entrepreneurial movements of the multinational accounting firms in a realistic fashion. Consequently, the ICAI had no option but to endorse the presence of the multinational accounting firms and consequently the activities of the surrogate firms. In other words, the role of the professional association may be multi-faceted altering with the circumstances of the marketplace. Once its own legitimacy was challenged, the reproductive role gave way to the reforming role thereby enabling the legitimation of the change.

Finally, it has been argued that change follows conflict of interests (Abbott, 1988; Hoffman, 1999). In the present setting, there were sharp differences of interests between professional subcommunities, and it was the larger and the more powerful subcommunity that desired change. In the Canadian setting, Greenwood et al, (2002) concluded that despite the lack of conflict of interests, the profession sought a normative endorsement of the change. This explanation would suggest that in the presence of sharply contested interests as observed in the current setting, the ICAI should have appealed more strongly to moral reasoning rather than market forces to justify the change. However, as the evidence in the paper suggests, while the ICAI did frame the change to be within the “core values” of the profession, it also appealed to the need to “recognize the changes in the global environment , globalization of business and competitive pressures”(ICAI, 2000:1) while justifying the change in the theorization process. One possible explanation could be the “permeability” or “plasticity” (Fox-Wolfgram et al., 1998) of professional boundaries. Professional communities may respond differently to the movements of constituent subcommunities. The legal profession has, for instance, been argued to be less open than accountancy to new ideas and law societies have been pronouncing against multidisciplinary practices (Greenwood et al., 2002). The reason forwarded is that the accounting profession exhibits greater plasticity in its identity than does the legal profession. However, the

preceding discussion suggests that accounting professions in different settings may also exhibit different plasticities. For instance, the Indian accounting profession may respond differently to change despite sharply contested interests as opposed to the Canadian accounting profession. Further research is needed to uncover the determinants of the plasticities of different professions or the same profession in different settings. Another explanation could be the role played by professional associations in the commercialization of the accounting profession. For example, it would be useful to examine whether claims to ‘gentlemanly’ and professional values might be a strategy to be commercial. Appeals to such forms of social and cultural capital can be an effective strategy for professionals in developing their business and being profitable (Cooper, Hinings, Greenwood, & Brown, 1996).

#### *Theorization and Diffusion*

Legitimation, which is the central task of theorization, has been argued to take different forms in professionalized setting as opposed to commercial settings (Greenwood et al., 2002). In a highly professionalized setting, it has been argued that commercial pressures may precipitate institutional entrepreneurship, but diffusion requires a normative justification. On the other hand, in commercial settings, it has been argued that change often spreads through the mimetic mechanism (DiMaggio & Powell, 1983; Strang & Soule, 1998). For instance, Haveman (1993) showed that savings and loans firms entered new market niches in increasing numbers once those niches had been occupied by large reputedly successful corporations. Similarly, Haunschild and Miner (1997) showed that firms’ choices of investment bankers were affected by earlier choices made by large successful firms. These studies imply that mimicry occurs because a course of action is legitimated by its use of others. The basis of legitimation is primarily economic. In the present professionalized setting, however, one can see that the mimetic mechanism is more



apparent. While the ICAI did try to frame the change within the values embedded in traditional beliefs, it primarily appealed to the “market potential and advantages” of the change. Also, once the surrogate firms formed by the multinational accounting firms and large local accounting firms were formed, the ICAI constituted the Rules of Merger and Demerger (ICAI, 2005) exhorting the local accounting firms to form ‘networks’ of firms to provide services to clients. These rules clearly seek to mimic the surrogate arrangement innovated by the large well-established firms in the Indian accounting profession. This leads us to believe that the proposition that legitimation in professional setting has to be a function of professional appropriateness alone, seems to be an oversimplification.

Further, it has also been argued that diffusion follows successful theorization. However, as the evidence in the paper suggests, the ICAI’s attempts at theorization cannot be termed as successful as evidenced by the tone in the white paper and its open call for the withdrawal of the licenses granted to the multinational accounting firms to operate in India. The passage of the Chartered Accountant (Amendment) Act, which by recognizing partnerships between members (local accounting firms) and non-members (multinational accounting firms) clearly points to the institutionalization of the presence of the multinational accounting firms in India. One possible explanation, as outlined earlier, is that organizations are complex entities with highly contested values. The resolutions of contested values depend upon how well groups can successfully appeal to, and draw upon, wider institutional and market forces and differs from field to field (Hinings and Greenwood, 1996). Fields vary in the degree to which they have clearly legitimated organizational templates combined with highly articulated mechanisms (the state, professional associations, regulatory agencies). In fields where the mechanisms for the deployment of the templates are weak, theorizing the change and subsequent diffusion of new ideas might be done

more easily than in fields with stronger mechanisms. Further research is needed to draw out the complex ways through which new ideas get institutionalized and objectified in similar settings.

In this paper, I have examined the change in the Indian setting through the lenses of all the stages of the model of non-isomorphic change in institutional theory. Further, I have attempted to understand the diverse roles played by professional associations during the process of change. Specifically, I have examined the role of professional associations in the theorization process against the backdrop of sharply contested interests in the organizational field of the accounting profession. Finally, this paper has demonstrated the diffusion of new ideas in an accounting setting despite unsuccessful execution of the theorization process. Future research will be aimed at examining each of the stages in the model in a more detailed manner in the current setting.

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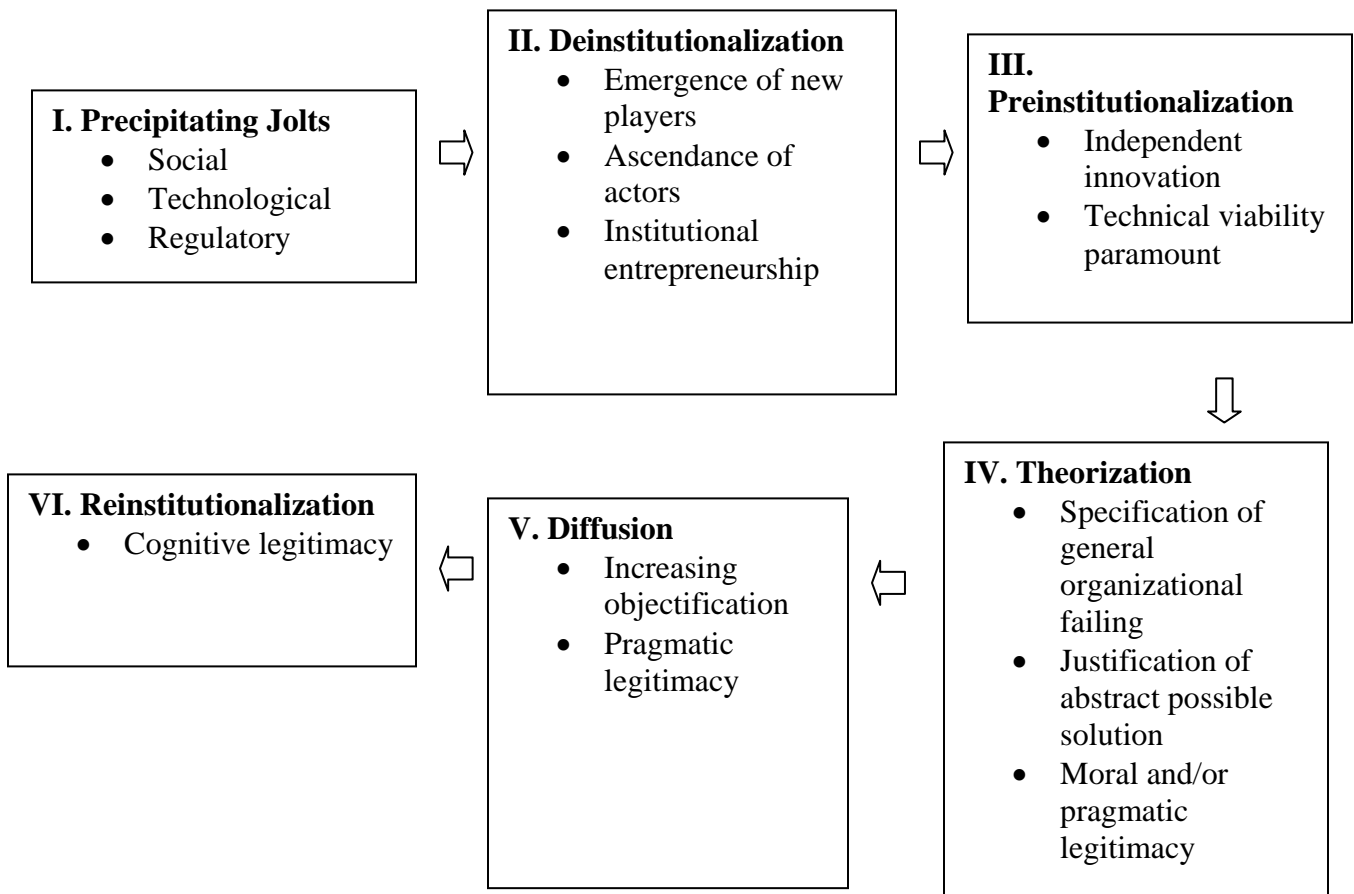
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**Figure 1:Neo-Institutional-Model-of-change**

**APPENDIX A:  
LIST OF AUTHORITATIVE SOURCES**

<b>Document</b>	<b>Year</b>	<b>Source</b>
White Paper on Multinational Accounting Firms operating in India	2002	The Chartered Accountants Action Committee For Level Playing Field
Vision Document	2005	The Institute Of Chartered Accountants Of India (ICAI)
ICAI President Messages	1990-2005	ICAI website
ICAI Annual Reports	1990-2005	ICAI website
Rules of Network and Merger-Demerger amongst the firms registered with the ICAI	2004	ICAI website
The Chartered Accountant (Amendment) Act	2006	ICAI website
World Trade Organization GATS Regime: Implications For the Accountancy Sector	2002	The Chartered Accountant Magazine
ICAI Patrika	2005-2006	ICAI website
Student Newsletter (ICAI)	1995-2006	ICAI (New Delhi)
Press Releases(ICAI)	1995-2006	ICAI(New Delhi)

**APPENDIX B:  
INTERVIEW DETAILS**

<b>Date of Interview</b>	<b>Interviewee</b>	<b>Country</b>	<b>Occupation</b>	<b>Work Experience</b>
July 2006	201	India	Head of Audit Function in a Big Four Firm in India	More than 10 years of audit experience in the Indian market and director of a Big Four surrogate firm
July 2006	202	India	Head of Audit Function in a Big Four Firm in India	More than 8 years of experience in audit and director of a Big Four surrogate firm
July 2006	203	India	Senior Audit Manager in a Big Four Firm in India	Five years of audit experience with a medium sized local accounting firm
September 2006	204	India	Author of the White Paper	A Chartered Accountant and an investigative journalist
September 2006	205	India	Author of the White Paper	Retired Bureaucrat
September 2006	206	India	Author of the White Paper	Chartered Accountant
September 2006	207	India	Author of the White Paper	Chartered Accountant
October 2006	208	India	Partner of a local accounting firm in India	More than ten years of audit experience in India
October 2006	209	India	Partner of a local accounting firm in India	More than fifteen years of audit experience in India