EXTRACT

SOURCE GLOBAL RESEARCH

January 2019

The Challenger Audit Brand: Impossible or inevitable?

Emerging Trends

Contents

Introduction

The essential process of audit—gathering data and reviewing a company's accounts and performance—hasn't changed significantly in decades. True, the scope of an audit has evolved, and new technologies are already starting to have an impact on the amount of work and timescales involved. But if a client had fallen asleep in the 1960s and woken up in 2019, the basic process an auditor goes through—the "what" of the audit—would still be remarkably familiar. It might not be for long.

Change is coming, largely as a result of the long over-due automation of manual data gathering and other work that represents so much of the audit process. Another 10 years asleep, and our client might wake up in 2029 to an audit that they no longer recognise.

But what about the auditor themselves? So many changes, so long delayed, create the raw ingredients for disruption and the entrance of new players into the audit market, challenging the hegemony of well-established players. Will the story that unfolds in the audit industry follow the same pattern we see elsewhere?

This report seeks to answer three questions:

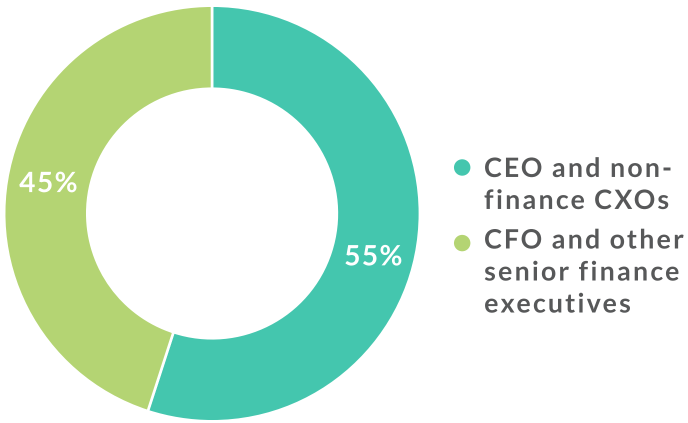
- **What is the potential for disruption in the audit industry?** With so much of the audit process bolted down by regulation, you'd be forgiven for thinking that the probability of change is almost non-existent. But, if we look at the indicators of disruption that apply specifically to the professional services sector, all may not be quite as rosy as it seems for the world's leading accounting firms.
- **How well prepared for disruption are existing audit firms?** Disruption and technology are inevitably intertwined, and our research suggests that technology firms will benefit as a result.
- **How can new entrants create a sustainable competitive advantage?** We'll argue that simply being better than audit firms at technology isn't sufficient. Technology firms will need to do more—and the key to that, we think, lies in them deliberately setting out to create a challenger audit brand.

About our research

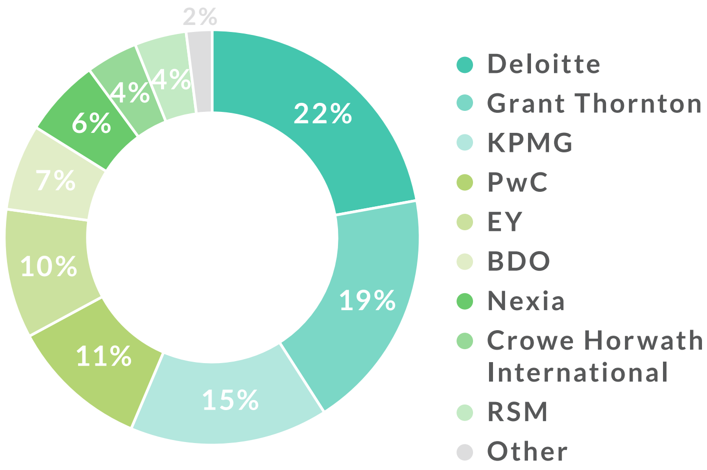
We surveyed 150 senior executives in September 2018, 100 of whom were based in the US, and the remaining 50 in the UK. The sample was split reasonably evenly between people in mid-sized organisations (1,000-4,999 employees) and large ones (5,000+). Forty-three percent of respondents came from the financial services sector, with most of the rest coming from other parts of the private sector. Public sector respondents accounted for just 3% of the total. The sample was also split between finance and non-finance people, but all were senior executives and all had been involved in selecting their organisation’s auditor and worked with the latter. It was important for this research that we looked not just at the Big Four, but also at mid-sized accounting firms. Overall, 58% of those surveyed were audited by the Big Four. The sample was also split roughly evenly between organisations whose current auditor had been in place for less than three years, between three and five years, and more than five years.

In addition to this data, most of which was gathered in October 2018, we occasionally also draw on two other surveys of audit clients, carried out earlier in 2018 and in 2017, of around 100 senior executives in the US and UK, and 150 executives in the US respectively.

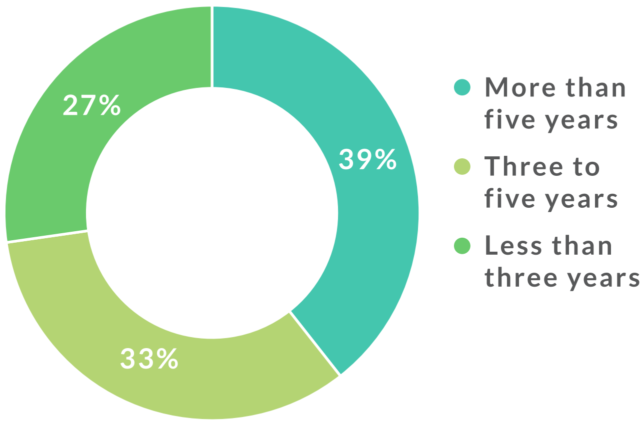
Split of respondents by job title



Current auditor



Split of respondents by length of relationship with current auditor



Section 01

What is the potential for disruption in the audit industry?

01

What we mean when we talk about disruption

The word disruption is used liberally, often simply to indicate an unusual level of innovation. But even its original usage in business, inspired by Clayton Christiansen's book The Innovator's Dilemma, was vague. "Disruption" meant changes to an industry or individual organisation's business model. It might involve new products and services. Certainly it meant waking up to a world in which you faced new competitors, often from unexpected quarters. Disruption is both an opportunity and a threat, the door to new rules of engagement that can be walked through in both directions, taking you to meet new customers, but enabling other organisations to meet yours.

In this report, we're trying to write about disruption in more specific terms. Our view is that disruption is less to do with new technology or new products and/or services, and is all to do with customer behaviour.

Industries get disrupted when customers change their behaviour. Organisations get disrupted when their customers change their behaviour en masse. Want to know what disruption looks like in practice? Imagine what it's like to wake up one day and discover that all your customers—all of them, not just some of them—have left you and now buy from your arch competitor. It's hard to believe that's possible, but the history of business is littered with organisations that thought it wasn't possible, only to find, almost overnight, that it was.

The purpose of this section of our report is to look at the factors that might provide early warning that the financial audit industry could be disrupted in the future.

Section 02

How well prepared for disruption are existing audit firms?

02

The existing rules of engagement

Every audit firm knows how the current world works—and so do their clients.

If you ask clients about the criteria they'd refer to when choosing their auditor, they're looking for knowledge of their industry/organisation, and expertise. Three out of the top five criteria are related to these two areas: 40% would put a firm's understanding of their sector at the top, and 32% would cite its understanding of their organisation. Beyond these key areas, a firm's reputation and its culture are also important.

Sector/organisational knowledge is more important among UK clients than among their US counterparts, whereas a firm's reputation with the board is relatively more important in the US. This latter factor is also much more important in large organisations.

Such findings don't surprise us: Our research in other professional services sectors follows a similar pattern. But they may also be irrelevant: These are the selection criteria of today's market, and don't reflect how clients' thinking may evolve in the future. Extrapolating from our findings in Section 1, we'd hypothesise that the way in which an audit firm uses technology in the future will become much more important (at present, only 5% of organisations say it's one of their top two selection criteria).

The aim of this section of our report is to explore, not how clients see an audit firm today, but how it's likely to view that firm tomorrow, particularly in relation to technology.

Section 03

How can new entrants create a sustainable competitive advantage?

An opportunity to go beyond the usual rules of competition

It's one thing to nip at the ankles of the Big Four by out-performing them around technology, and quite another to position yourself as a challenger brand. The former presupposes a fairly gradual transition from one set of market dynamics to another; the other is predicated on making change happen quickly.

We've argued that clients' willingness to separate out the different components of the audit process, thereby opening them up to competition from non-audit firms, will be the most important driver of disruption. Our data indicates that technology firms will be the main beneficiaries of this shift, but it also suggests that this isn't a fait accompli. Most clients think that the quality of work done by their auditor is high and are not overly concerned by market inefficiencies; many think that, while auditors may not have been on their front foot where technology change is concerned, they're likely to improve their offering over time.

When we ask clients who they think will challenge traditional audit firms they again cite technology firms, or at least 76% of them do: 45% point to technology services businesses (the Accentures of this world) and a further 31% suggest software and data companies (we suggested Amazon and Google as examples). Law firms and strategy consulting firms got a much smaller look in. Asked why they think this type of firm could challenge the status quo, those choosing technology services companies unsurprisingly cited their deep technology expertise, while software and data companies were also chosen because of their strength in data processing.

But, we'd argue that technology firms can't afford to be complacent. Simply being seen to have better technology capabilities at the moment won't be enough to guarantee a sustainable competitive advantage in the future. To secure the latter, they'll have to do something more—they'll have to create a brand that appeals to audit clients' emotions, not just their logic, and do this in a sufficiently compelling way that the clients of traditional audit firms are prepared to switch supplier en masse.

But what could that look like in practice? By way of a conclusion, this final section of our report speculates about the type of challenger brand that might work in the audit industry.

About the author

Fiona Czerniawska

A Co-Founder and Director of Source, Fiona is one of the world's leading commentators on the management consulting industry. Since founding Source in 2007, she has been bringing this expertise to bear on our clients' most pressing strategic projects and business issues.

Fiona has more than 20 years' experience as a management consultant, working primarily in the areas of marketing and strategy. She was previously in charge of strategic planning for EY in the UK and has worked in the consulting practice of PwC. Fiona also has a PhD in seventeenth-century French art and lives in hope that it will be of practical use in business someday.

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Programme schedule for 2019

Reports 2019	Market Data and Analysis	Client and Brand Insights	Emerging Trends
January	Forecasts for 2019		
February	UK	UK Nordics GCC	
March	GCC Benelux Nordics	France Germany US	The Future of Pricing
April	France DACH Southern Europe	Energy & Resources Financial Services Healthcare Technology, Media & Telecoms	
May	US Eastern Europe & Russia		The Value Problem
June	Canada	Global Perceptions of Audit Firms Global Perceptions of Risk Firms Global Perceptions of Tax Firms	
July	South America Australia		
August	Africa Risk		The Make-Buy Decision
September	India Energy & Resources Planning for Growth in 2020	Talent Attractiveness in 2019	
October	Financial Services China South East Asia		
November	Japan Healthcare Technology, Media & Telecoms		The Future of Delivery
December	Tax		

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