DETERMINANTS OF AUDITING FIRMS GROWTH IN TANZANIA: A CASE OF SELECTED FIRMS IN KILIMANJARO AND ARUSHA REGIONS

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ABSTRACT

Tanzania has witnessed the growth in the auditing industry spearheaded by the mandatory requirement of having audited financial reports to all businesses for the consumption of stakeholders including the Government. Despite such growth and the need for auditing services, auditing firms have remained to be in small size category while few are found in the medium size and fewer in the large size firm. The aim of this study was to analyse the determinants of auditing firms' growth in Tanzania while using Arusha and Kilimanjaro regions as a case study. The study used primary data collected through questionnaires administered in a sample of 99 respondents, including 33 Auditors, 33 Managers and 33 Partners. The study used Multinomial Logit Model (MNL) since the dependent variable had multi category choice outcomes (polychotomous). Findings revealed that financial capacity, regulatory framework, managerial capability and staff competency were statistically significant and therefore prerequisites in the growth of auditing firms. The study recommends that NBAA employ regulations that will support small size auditing firms graduation to subsequence categories i.e. medium and large sized firms, also small auditing firms should think of merging in order to bring together financial, staff and managerial resources which are better enjoyed with large scale firms as evidenced by the four (4) big auditing firms of PwC, KPMG, Deloitte and EY.

Keywords: *Growth, small auditing firms, Multinomial Logit Model (MNL), financial capacity, regulatory framework, staff competency, managerial capability.*

1. INTRODUCTION

Auditing is a vital exercise for any organization in order to know its financial and operational health. Leggat and Martin (2017) ascertain that auditing dates back from agrarian revolution with the main objective being to detect and prevent errors and fraud, it then evolved and grew rapidly with the growth of the joint stock companies after the industrial revolution in the eighteenth century while the main objective being to give opinion whether financial statements present true and fair view of the information to the users. The ownership and management became separate that, the shareholders needed a report from an independent expert on the accounts of the company managed by the board of directors appointed by them. In actual sense audit refers to an investigation or search for evidence to enable an opinion to be formed on facts or truth and fairness of financial and other information by independent person or persons (Gray and Manson, 2008). Deemay (2019) argues that over the years the accurate role of auditing worldwide shifted and was expected to ascertain whether the accounts were true and fair rather than detection of errors and frauds, after World War II the focus on business and commerce industries was to come up with necessity of making proper accounting records and find a need to be audited to ensure reliability of their financial information by users like lenders, suppliers, government and even stakeholders. It is through this transition period for industrialization where the developed and developing countries adopted the auditing fundamental principles to deliver a fair view of the books of accounts.

The idea of having large scale auditing firms originated with small auditing firms owners who aspired to be giants of the auditing industry, these were Arthur Andersen, Coopers and Lybrand (PwC), Ernst and Whinney (EY), Deloitte Haskins and Sells, Peat Marwick Mitchell (Deloitte), Touche Ross, and Arthur Young (KPMG). They tolerated the idea of merging their firms which in turn gave increased their financial, managerial, staff competencies which also led to these firms to have larger share of operations in the world and the revenue they generate. The firms are now known as the *big four* accounting firms, the firms include: PricewaterhouseCoopers (PwC), Deloitte and Touche, Ernst and Young (EY), and KPMG (De Angelo, 1981). On the other hand, in Africa the size of a firm has been one of the most widely discussed phenomena in management, economics and accounts. Shaheen and Malik (2012), suggest that firm size is linked to the quantity and array of production capability and potential that a firm possesses or the quantity and diversity of services a firm can concurrently make available to its clients; they suggest that firms that grow enjoy some sort of specialisation that makes them more reliable and efficient in performing certain task, the growth also minimises some of the cost that are associated with the provision of service.

Firms have been argued by neo classical economists to have been established primarily for the purpose of making profit, managerial economists such as Baumol (1967) showed that firms are more into ensuring that there is sales maximisation and inevitably growth in revenue; Growth is therefore understood to be the main concern of any related firm irrespective it is viewed from which angle; auditing firms like other firms are categorised into small, medium and large scale in terms of size. Francis and Yu (2009) suggest that large auditing firms have more independence with higher quality in their work with more intent to detect material problem in financial statements, they are also perceived to be independent because of their revenue power and hence they are free to offer qualified audit opinion. Sawan and Alsaqqa (2013) suggested that audit firm size in Libya was relevant as it positively related to the audit quality and that large auditing firms were attributed to have prowess in resources, audit technology, and the motivation to perform as professionally as possible. The Auditors and Accountants (Registration) Act No. 33 of 1972 established the National Board of Accountants and Auditors (NBAA) as the auditing standard-setter in Tanzania. In 2004, the NBAA adopted ISA without modifications for application in all audits in Tanzania. Thereafter conducting an audit became more reliable because the reports were under supervision and hence, professional examinations and trainings for accountants and auditors started to be offered by NBAA, the board is also responsible to register firms that intend to work in the profession(s) of Accountancy and Auditing, (NBAA, 2019).

In Tanzania there are 248 auditing firms categorized into small, medium and large size respectively (NBAA, 2019). Most of these firms fall in the small size category which is 89% of all firms, medium sized which is 10.7% and large sized firm that forms only 0.3% of the total firm. This poses a question as to why many small size auditing firms do not mature to the subsequent levels of medium and large scale firms despite rooms for such growth as evidenced by the growth in the business sector where business establishments increased from 69,142 to 154,618 entities in 2011/2012 and 2014/2015 respectively (NBS, 2016). This study therefore was set out to analyse the determinants for growth of auditing firms while focusing on factors contributing to small auditing firms growth from small to medium and eventually to a large sized firm in Tanzania.

2. THEORETICAL REVIEW

Gibrat law proved that the firms have the same possibility of growth despite their initial size. It shows how firm growth depends on random shocks that are independent of each other and on the initial firm size. The theory assumes that there are expected and unexpected shocks which are independent of one another, these shocks are what causes a firm to either grow or to remain as it is. The theory further shows that all firms have the same possibility of growth despite their initial size (Carrizosa, 2007). In actual fact, a firm's growth is the outcome of a multiplicative process that affects the initial size. The factors that can affect firm growth relate not only to the firm, but also to its environment.

2.1 Financial capacity

Financial capacity also plays an important role in the general growth of firm, Oliveira and Fortunato (2006) studied 7653 manufacturing firms from 1990-2001 in Portugal where they established that smaller and younger firms had higher growth-cash flow sensitivities than larger and more mature firms. This is consistent with the suggestion that financial constraints on firm growth may be relatively more severe for small young firms. Small and young firms with strongly liquidity constrained exhibit more persistent growth. Elston (2002) using German, Austria, Britain, France, Israel, Ireland, Luxembourg, The Netherlands, Switzerland, the USA provided evidence that liquidity constraints impact firm growth even when controlling for firm size and age. Smaller firms grew faster in the new economy but larger firms grew faster in the old economy.

Carpenter and Petersen (2002) while using 1600 small manufacturing firms in the USA showed that growth of most small firms is constrained by internal finance, together with a small leverage effect. For firms facing internal financing constraints, growth rates may be approximately independent of size because cash flow is approximately independent of size. Fagiolo and Luzzi (2004) while studying 14,277 firms in Italy ascertain that smaller firms grow more and experience more volatile growth patterns after controlling liquidity constraints; the stronger liquidity constraints, the more size negatively affects firm growth.

Hutchinson and Xavier (2006) studied 34,028 firms in Belgium and Slovenia they established that a Cash flow coefficient is around one with SMEs having coefficient than Belgian SMEs indicating that Slovenian firms have a stronger relationship between cash flow and growth. Arora, Kumar and Verma (2019) in their study conducted in India spanning for 17 years using 203 firms in manufacturing sector by employing vector autoregressive model established that available growth options to firms increase their level of systematic risks, however systematic risks were observed to be declining when firms start to increase their assets in place, this implies that growth oriented firms are necessary for the reduction of systematic risks. Polle (2017) in a study on challenges facing auditors in auditing implementation strategies. Using cross-sectional with 120 respondents in Nairobi analysed data using qualitative and a multinomial Logit regression model. The researcher found that there are several challenges facing audit firms in the implementation of strategy, mostly due to insufficient financial resources.

2.2 Regulatory framework

Good regulatory framework provides essential protections from risks posed by day-to-day in business operation. It also protects businesses, ensuring fair competition and a level playing field. Good regulation is also good business. It can reduce compliance costs by clarifying requirements, providing accessible advice about solutions, developing monitoring processes, and enabling recognition of investment in compliance. In developing economies as established by Batjargal (2005) and Guseva (2007) firms that has no ties to government officials are significantly facing barriers to entry and inevitably their growth is hindered. Elbayoumi *et al.,* (2019) conducted a study on influence accounting and auditing in company developments in Egypt. To test the hypothesis, the binary logistic regression model and the chi-square test were applied. The study found that development of accounting and auditing in Egypt was somewhat weak because of the lack of investor protection, legal inefficiencies and weak enforcement mechanism. A study by Adomako and Danso (2015) conducted in Nigeria using a sample of 372 entrepreneurial firms established that weak and underdeveloped regulatory environment negatively affects firms performance regulatory. Also as established in Russia by Batjargal (2005) and Guseva (2007) this study also established showed that political ties where needed for growth of firms. Laws governing private enterprise are usually unnecessarily complex and difficult to understand, the regulatory environment which is always perceived to be poor is also coupled with added cost of corruption and bribery (Stevenson, 1998; Pope, 2001; Kiggundu, 2002). A report by World Bank (2020) on Doing Business report ranked Tanzania as 141 out of 190 that were checked on how easy it was in doing businesses in their economy, the measure shows the economy's absolute position relative to the best regulatory performance.

2.3 Managerial capability

Managers play a vital role towards the success and failure businesses. They are the one who carry the weight of the day to day functioning of firms, their decision may be inspired by their perception towards risks as famously categorized by three forms of risks behaviours; namely risk lover, neutral and averse. A study by Kotey and Meredith (1997) categorized maanagers into two categories of "entrepreneurial managers" and "conservative managers". After studying 224 small firms in Australia the study revealed that manager's personal values, business strategies and firm performance were empirically related. A study by Huck and Thadeus (1990) from a survey of 54 firms in Jamaica showed that manager's competencies in management, planning, budgeting and marketing were vital for the success of a business. Innovativeness, know how, creativity, managerial competency proved to nbe vital for the growth small scale firms in Canada (Chaganti and Chaganti 1983); high performing managers/entrepreneurs were also seen to have an entrepreneurial background, with a much broad sense of the business environment in a study that was carried in the USA by Duchesneau and Gartner (1990) were 26 firms were extensively investigated. De Zoysa and Herath (2008) conducted a study in Japan were 367 small firms were studied, the findings showed Managers needed to be more entrepreneurial minded their strategies and actions in order to achieve better performance during the introductory and decline stages on the other hand they need to be more administrative oriented for achieving better results in the growth and maturity stages. Kolvereid and Amo (2019) conducted a study on determinants of firms' growth in Norway. A survey research design was adopted in the study, where a sample of 88 respondents was obtained through multi-stage sampling. Interviews, questionnaires and record analysis were used as data collection techniques where the chi square test and various regression methods were used to evaluate data.

2.4 Staff competency

Human resource forms the most important aspect for any firm effective functioning, competent staff can be spearhead rapid growth and its maintenance, conversely can be hindered if staff and not competent enough to accomplish is required of them. Evidences suggest that it is important to attract competent staff and provide staff incentives that are meant to attract, motivate, retain and promote employees productivity (Landau and Leventhal (1976), Weitzman and Kruse, (1990) Zenger (1992) and Rich 1999). The number one priority of many CEO's was disclosed to be proper staffing according to PricewaterhouseCooper's Trendsetter Barometer (2000), by attracting and retaining skilled and competent employees firms are put in better position to effectively implement a growth-oriented perspective (Rich 1999). Naslmosavi *et al.*, (2013) conducted a study on effect of audit firm size on independent auditor's opinion, the target audience consisted of eight major coffee marketing firms in Kenya. The study found that effectiveness and quality of opinion developed by the auditor about the financial statements is significantly important, because financial statements should be reliable, useful and relevant for investors and creditors. A significant issue raised in accounting literature is whether judgments of auditors from large firms vary substantially from those of auditors employed by other firm and whether small auditing firms can attract staff with needed quality and efficacy to carry auditing works.

2.5 Objective

The main objective of the study was to analyze the determinants of auditing firms' growth in Tanzania. To achieve this objective the study employed a case study in two regions of Arusha and Kilimanjaro. Where by it looked on the relationship between financial capacity and growth of auditing firms, examine regulatory framework effects on growth of auditing firms, the effect of managerial capability in growth of auditing firms, and effectiveness of staff competency on growth of auditing firms.

3. METHODOLOGY

This study was carried out in Kilimanjaro and Arusha regions in Tanzania and cross sectional research design was adapted. According to NBAA database the two regions had a combined total of 33 operating small scale firms, both firm were involved in this study. A sample of 99 respondents was selected to participate in the study through professional scepticism whereby the researcher had a room of using professional judgment due to the nature of the firms being small. The sample comprised of 33 partners, 33 managers and 33 auditors from all 33 firms in Kilimanjaro and Arusha Regions.

4. THE MODEL

The study employed a Multinomial Logit Model (MNL) since the dependent variable had more than two unordered or multi category choice outcomes (polychotomous) as suggested by Hyun (2006).

5. FINDINGS

Objective One: Relationship between financial capacity and growth of auditing firms.

The study hypothesized that there is no significant relationship between financial capacity and firm's growth. Chi-Square test used to check the strength of association between financial capacity and firm's growth at 95 % confidence level. The test result showed that there is a significant positive relationship between financial capacity and small auditing firm's growth. The findings of this study suggest that financial capacity is an important aspect for growth of small auditing firms, graduating to medium size auditing firm and eventually to large scale firm seems to be an improbable journey without adequate financial capacity. Financial capacity seems to be of high importance not only in this study but also in other studies that focused in other areas other than the auditing industry this include in manufacturing and entrepreneurship as ascertained by Arora et al. (2019), Oliviera and Fortunato (2006), Fagiolo and Luzzi (2004) and Elston (2002).

Objective Two: How regulatory framework affects the growth of auditing firms.

This study hypothesized that there is no significant relationship between regulatory framework and growth of auditing firms. Chi-Square test used to test the strength of association between regulatory framework and growth of auditing firms at 95 % confidence level. The Chi-Square test revealed that there is a significant relationship between the regulatory framework and the growth of auditing firms. The findings of this study suggest that a strong regulatory framework is pivotal towards the growth of small of auditing firms to large ones, strict laws and regulations were seen to be a difference to progression to further categories for small auditing firms in Arusha and Kilimanjaro regions. Issues such as the amount of capital, number of employees, number of partners and years of experiences for a firm to progress to the categories of medium and large scale was observed to be a hindrance of growth for the small auditing firms that were studied. Even for a firm that could have probably had a relative advantage in other areas of financial capacity; managerial capability and staff competency still the available regulations were a hindrance for further growth. The findings of this study are in line with what was previously revealed in related studies by Batjargal (2005) and Guseva (2007), Adomako and Danso (2015) and Elbayoumi et al., (2019) both shows that the inadequate growth of firms in developing countries was a result of weak regulatory framework.

Objective Three: The effect of managerial capacity in the growth of small auditing firms.

The study hypothesized that there is no significant relationship between managerial capability and firm's growth. Chi-Square test used to check the strength of association between managerial capability and firm's growth at 95 % confidence level revealed that there is a significant relationship between managerial capability and small auditing firm's growth. Audit firms, on the other hand, are becoming increasingly vulnerable to and affected by the challenges of inadequate market and growth connections. The data analysis in this study suggest that managerial capability is vital in the growth of small auditing firms, managers attribute towards growth was seen to a significant factor towards the growth of auditing firms. It is thus relevant for auditing firms to concentrate in recruiting managers who are growth oriented rather than conservatives who are satisfied with the status-quo, perhaps by recruiting growth oriented managers rather than conservatives small auditing firms will be able to put strategies that can propel them towards growth from small scale category to medium and eventually large scale firm. The study findings supports the findings by De Zoysa and Herath (2008), Huck and Thadeus (1990) and Kotey and Meredith (1997) who underpinned the importance of managerial capability towards growth of firm.

Objective Four: Impact of staff competency on growth of small auditing firms.

The study hypothesized that there is no significant relationship between staff competency and growth of the firms. Chi-Square test used to check the strength of association between staff competency and growth of the firms at 95 % confidence level. The findings depicted that there is a positive significant relationship between staff competency and growth of the small auditing firms because clients will observe number of qualifications a firm has, in order to decide whether to work with the firm or not depending on the size of activities a firm has. Staff competency was found to have an association with the auditing firm growth, the findings revealed that variable were strongly related, and the variation in growth while keeping other factors constant showed that there was a strong association of about 90.6%. The findings of the study were similar to the findings from other studies by Landau and Leventhal (1976), Weitzman and Kruse, (1990) Zenger (1992) and Rich (1999) also showed that competent staff is the ones forming the most important aspect of the firm resources and were very pivotal to the growth of firms. Therefore measures such as providing incentives that are meant to attract, motivate, retain and promote employees productivity should be put in place by firms to retain competent and also to attract new talents, since without these measures then small auditing firms are in danger of losing existing competent staff and not attract newer ones.

6. CONCLUSIONS AND RECOMMENDATIONS

This study suggest that financial capacity, staff competency and managerial capability are vital for the growth of small auditing firms; the variables disclosed here are all found to within the reach of the firms themselves. On the other hand regulatory framework is also seen to be an important aspect for the growth of these firms, however the findings showed that of the 33 surveyed small scale auditing firms that were operating in Arusha and Kilimanjaro regions respectively, disclosed that the regulations including the capital needed to enter the categories of medium and high scale were on high. The study also shows that the majority of small auditing firms did not want to lose their firms even if it meant this could result to more profits to them, this was evident by the fact the majority were against mergers and acquisition even if the law allows the same, this is quite the contrary to what was done with the four (4) giant auditing forms of EY, PWC, Delloitte and Touche and KPMG.

This study recommend that small auditing firms should tolerate the idea of mergers and acquisition to firm auditing conglomerates which will propel them towards growth to medium and eventually large scale firm categories within the auditing industry. By merging the firms will have leverages in financial capacity by attracting financial resources, managerial capability through recruiting capable and growth oriented managers, staff competency by attracting competent auditors with necessary expertise. Moreover the role of regulatory framework is also observed in this study, issues such as huge initial capital for being categorized in the medium or large scale criteria in the auditing venture, high number of needed staff as well as years of experience should be widely looked upon by respective authorities including the NBAA.

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