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## **An analysis of the competitive business environment of a family run Brazilian auditing firm**

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**Abstract:** The growing reality of globalisation has contributed too many new challenges in the auditing and related services industries, which placed more pressure on audit firms' of all sizes drive for long-term sustainability. Just like their global counterparts, audit firms in the Brazilian marketplace also need to be cognisant of its own competitive business environment in order to survive in a very competitive environment. However, in such a dynamic business environment, organisational resilience becomes a crucial building block in achieving sustainability. The key objective of this article is to identify and consider key factors in the competitive environment of an established nationally-based Brazilian audit firm, that not only embraces a thorough understanding of its business environment, but also of resilient strategies to support the firm's long-term sustainability. Based on a PEST and SWOT analysis, it was found that the firm's internal competencies and business environment, as well as the unpredictable role of government together complex bureaucratic regulations, makes for both challenging and promising times in the Brazilian auditing and related services industry.

**Keywords:** Brazilian audit industry; competitive business environment; corporate strategies; organisational resilience; PEST analysis; sustainability; SWOT analysis; Brazil.

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## **1 Background**

### *1.1 Introduction*

The drive to attain long-term sustainability in a modern services industry firm, presents its management with dire challenges in itself. Adding to these challenges are a multitude of new management theories, tools and frameworks that were developed over the past two decades or so, such as customer relationship management (or CRM) (Bull, 2003), total quality management (or TQM) (Rodrigues, 2007), globalisation (Drucker, 1986), environmental analysis (Dess and Origer, 1987), resource-based strategic development (Barney, 1986a, 1986b, 1991; Peteraf, 1993; Wernerfelt, 1984), workplace democracy (Rayasam, 2008), value chains (Gereffi et al., 2005), knowledge worker (Edersheim, 2007), game theory (Clark, 1992), decision support systems (or DSS) (Clark, 1992), all claiming to provide the *roadmap* to corporate resilience and long-term sustainability. With all these developments, management is often faced with information overload, without knowing where to start or which direction in to go.

In consideration of the above, the dynamic and complex Brazilian business environment face many unique challenges. To provide some context, the following serves as background:

- The country has very complex tax laws and regulations, and is riddled with *governmental bureaucratic obstruction* for aspiring businessmen (The Economist, 2009) which result (for example) in it taking up to 2,600 man hours to complete a medium-sized company's annual tax-return (IFC, 2010) and up to 120 days to start and register a company (IFC, 2010).
- Although the country experienced hyperinflation of up to 764% in the 1980s and 1990s (The Economist, 2009), foreign direct investment (FDI) in Brazil was up 30% in 2008 even as FDI inflows into the rest of the world fell by 14% (The Economist, 2009), while the country also has a potential market of 190 million people (CIA, 2010).
- Many multinationals' more profitable subsidiaries are also based in Brazil, including Nestle, AB Inbev and Portugal Telecom (Barbosa, 2010).

The current global financial crisis plunged most of the corporate planning functions of companies all over the world into chaos. Even though Brazil only experienced two quarters of the crisis (CIA, 2010), the complex and fast-changing business environment and the extreme level of bureaucracy make this a country where a competitive strategy and proper corporate planning are invaluable. On the contrary, having been awarded the FIFA Soccer World Cup in 2014 and the Summer Olympic Games in 2016 (CNN, 2009),

while also having a growth forecast of 5%, the country and many Brazilian companies stand to reap unprecedented successes if the right strategic decisions are made (CIA, 2010). It is estimated that between USD 16 billion and USD 48 billion of investment is needed in order to improve Brazil's infrastructure in preparation for the 2014 World Cup, while it is expected that around USD 15 billion will be invested in Rio ahead of the 2016 Olympic Games (Wilkins, 2009).

The Brazilian auditing and related consulting industry is hotly contested. With the requirements to become an auditor involving many years of experience, proper planning is essential. The process of becoming a chartered accountant/auditor in Brazil is as follows (IBRACON, 2009):

- a degree in accounting sciences from an accredited university (typically around five years)
- complete the National Accounting Board's exam and become a *registered accountant*
- complete five years of practical experience
- write the National Accounting Board's final exam and become a *registered auditor/chartered accountant*.

It is important to note that even after completing the above, one is still limited as to the type of audits one may conduct. In order to audit publicly listed companies, further education and experience are required.

With all the above in mind, one question that naturally arises is: How does an audit and related-services firm find its way in such a multifaceted environment and achieve its corporate goals with the resources it has available? An answer could perhaps be found in the combination of two key definitions of corporate strategy (Hax and Majluf, 1988); firstly, the *Schendel and Hatten definition* that contends that strategy starts with the basic goals and objectives of the firm, which are then supported by resource allocation; and secondly, the *Argyris definition* that contends that strategy formulation is based on the identification of opportunities and threats and the evaluation of strengths and weaknesses. Two models that have been developed to assist in filtering and analysing the necessary information to formulate strategies are the strengths, weaknesses, opportunities and threats (SWOT) model (BPP, 2008; Barney, 1995; IIBA, 2009) and political, economic, social and technological (PEST) model (BPP, 2008; Korkmaz and Messner, 2008). The combination of these models provides a holistic perspective on the firm, and takes the best of the contrasting perspectives of

- 1 Porter's *framework of competitive strategy*
- 2 the more recent *resource-based view* of the firm, on strategy formulation.

The framework of competitive strategy adopts an 'outside-in' perspective on the market structure and its effect on firm performance (Spanos and Lioukas, 2001), while the resource-based perspective redirects attention into idiosyncratic firm capital and postulates that performance is ultimately a return to unique assets owned and controlled by the firm (Spanos and Lioukas, 2001).

Searches of several academic databases (including Ebsco and Green Emerald) revealed very limited research on the competitive environment analysis of auditing firms. Furthermore, available research seem to gravitate towards large globally presented audit

firms, such as PricewaterhouseCoopers (Datamonitor, 2010), Deloitte Touche Tohmatsu (Marketline, 2012; Datamonitor, 2011); KPMG International (Datamonitor, 2012) and BDO International (Datamonitor, 2009). Although reports such as these report on aspects such as SWOT analyses of these firms, the focus tends to be on the on high-level issues in the global accounting context. There is a clear gap in the available research on the competitive environment of smaller audit firms, hence the objective of this research project to consider such smaller firms.

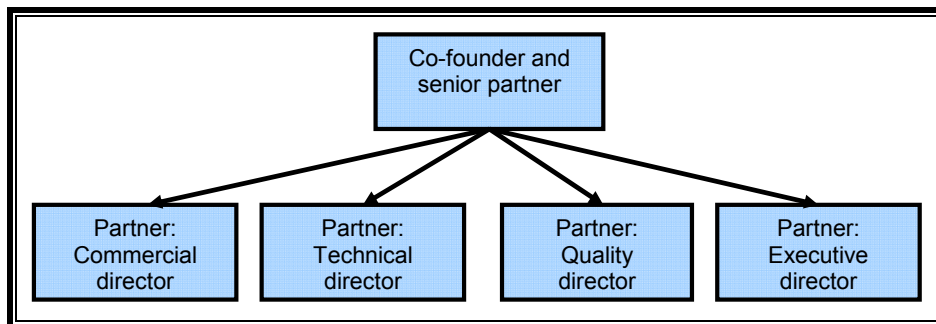
### 1.2 Research background and firm information

Brazilian Audit Firm Ltda (BAF Ltda) is a family run auditing firm that was founded in 1965 by the current senior partner and his father. The firm was one of the first 44 auditing firms to register with the Brazilian Accounting Association in its state and is one of the few of these firms that are still in operation. Furthermore, the firm currently has five offices in the major business centres of Brazil, namely São Paulo, Rio de Janeiro, Curitiba, Porto Alegre and Brasilia. It has a staff contingent of 114 together with an annual turnover of around USD 5 million. In 2008 they joined an international auditing and accounting network with offices in 76 countries, 7 600 employees and a combined turnover of USD 650 million.

The firm currently has four main service departments: auditing, IT auditing, tenders and international desk. They are rated as being in the top ten auditing firms in their field in Brazil and focus mainly on auditing, which is split into financial auditing and IT systems auditing. Until recently they also provided accounting services, but made the strategic decision to contract this function out so as to guarantee its own independence and objectivity.

The top management team of the firm was selected as the research participants in this research project.

**Figure 1** Top management structure (see online version for colours)



### 1.3 Problem statement and research objectives

Brazil, with its labyrinth-like tax system, high levels of bureaucracy and unique opportunities, creates a playing field in which companies need to choose between various variables in order to not only survive, but to achieve long-term sustainability. The research problems under consideration can therefore be defined as follows:

- P1: What is the internal and external environment in which BAF Ltda finds itself?
- P2: What is the best fit generic strategy for BAF Ltda that arises from the information identified in P1 above?

In addressing these questions, the primary objective of this research project is to analyse the competitive environment of BAF Ltda. In order to do so, the study will focus on three areas, namely

- 1 an internal analysis
- 2 an external analysis
- 3 a choice of best strategy.

These three focus areas will be addressed as follows:

- a PEST analysis in order to get the best possible understanding of the firm's external environment
- a SWOT analysis in order to uncover the key aspects impacting on the firm business operations
- generic strategy will be analysis in order to propose a best-fit strategy for the firm.

#### *1.4 Research method*

According to Terre Blanche et al. (2008) and Sekaran (2000), business research can be undertaken for two different purposes:

- 1 fundamental research, which is undertaken in an effort to enhance the understanding of organisational problems and to seek methods of solving it
- 2 applied research, which is undertaken with the intention to solve specific problems experienced.

Since this article considers practical aspects in relation to corporate strategies and resilience in a Brazilian auditing and related services firm, this research project can be considered as part fundamental research and part applied research.

To achieve the above mentioned objectives, a theoretical study of recent literature as well as an exploratory empirical study has been conducted. The theoretical phase of the study focused on explaining the managerial tools used to analyse the internal and external environments and also the generic strategy options available to the firm. The purpose of the literature review in this research project is therefore to:

- gain a thorough understanding of the corporate planning tools, i.e., PEST and SWOT
- gain a thorough understanding of the generic strategy options available to BAF Ltda
- using the above information as a foundation from which to develop the questionnaire for the structured interviews.

The empirical research phase aimed to provide an exploratory analysis of the internal and external environment of BAF Ltda. Sekaran (2000) states that an exploratory study is undertaken when little is known about the situation at hand. Questionnaires have been

distributed to the top management team, which were subsequently completed during semi-structured interviews. All interviews were conducted at BAF Ltda's offices in private meeting rooms during which the information was documented and summarised.

## **2 Assessing the competitive environment**

With the emergence of the large-scale organisation around the 1870s, such as the Transcontinental Railroad in North America and the 'universal bank' in Europe, the need for professional management was born (Drucker, 1986). During the 20th century, management has evolved on to become an integral and indispensable part of society and institution. With the study of *management* came the study of various other aspects of business and institution, such as firm structure, culture, human resources, communication and strategy. This was also greatly assisted by the management boom from the end of World War II to the end of the 1960s (Drucker, 1986). This was followed by the invention of personal computers and also the dramatic rise in the importance of technology strategy (Shane and Ulrich, 2004). From virtually out of nowhere, strategic management became a required business school course in MBA and undergraduate programmes, spurring greater amounts of research in the area. The study and rise of management information systems (MIS) in the early 1980s (Culnan and Swanson, 1986) which emerged from a supporting base of three foundational fields namely

- 1 computer science
- 2 management science
- 3 organisational science,

also made a great contribution to the further study of management as a science.

Seminal studies such as Clark (1992) demonstrates some of these management science tools and their specific application within strategic planning. Two specific developments within strategy formulation have been the PEST and SWOT analysis approaches through which a firm assessed its internal and external environments. This also fits in with how strategy has long been understood, i.e. as a process in which the firm simultaneously attempts to adapt to environmental constraints and to exploit existing capabilities (Kraatz and Zajac, 2001). A further development has been Porter's generic strategies, which grows from Porter's (1991) definition of strategy as being a consistent array or configuration of activities aiming at creating a specific form of competitive advantage, i.e., differentiation and/or low cost. These, together with the scope of operations, define the notion of generic strategies. Within this framework, strategy choice is the product of, and response to, a sophisticated understanding of industry structure (Spanos and Lioukas, 2001). These strategic management approaches are now briefly discussed.

### *2.1 PEST analysis*

von Bertalanffy, through his *general systems theory*, was one of the first to acknowledge the interrelationship among people, groups, organisations, and societies (von Bertalanffy and Rapoport, 1956). From this acknowledgement, the emphasis in the literature evolved onto the understanding of the relationship between the environment and the organisation.

According to Burt et al. (2006) the outcome of this examination was the development of definitions of the environment and of the behaviour of firms in their environments, which were subdivided at the *contextual environmental level*, as understood in terms of macro factors (such as political, economic, societal, and technological, hence the abbreviation of PEST) and *organisation-specific environmental level*, as understood in terms of choice of strategy by the organisation.

- The *political environment* is according to Hoskinsson et al. (2004) is the arena in which organisations and interest groups compete for attention, resources, and a voice in overseeing the body of laws and regulations guiding the interactions among nations. Although firms may not have direct control within the political environment, they can influence government through lobbying, non-executive directorships and by influencing public opinion (BPP, 2008). Although this study will focus on the contextual environment, both types mentioned above create contextual and organisational level opportunities, and problems for organisations, with organisations depending on the environment for scarce resources (Frishammar and Hörte, 2005).
- The *economic environment* is according to Hoskinsson et al. (2005), the nature and direction of the economy in which an organisation competes or may compete. Economic factors that affect a firm include the overall level of growth, the business cycle, official monetary and fiscal policy, exchange rates and inflation (BPP, 2008). This part of the framework may also assist the strategic planner to highlight probable areas of training for those stakeholders that have limited inputs with regard to the assessment of the economic environment.
- The *social culture environment* is according to Hoskinsson et al. (2004) concerned with a society's attitudes and cultural values. With the development of social networks, such as Facebook and LinkedIn and the expansive research done into emotional intelligence, this part of the framework analysis has grown in importance over the last couple of years. Here, the strategic planner can identify just how connected the management team is and how well they are using the diversity that is available in the current work environment.
- The *technological environment* is according to Hoskinsson et al. (2004) and Jiang and Alis (2009) the institutions and activities involved with creating new knowledge and translating that knowledge into new outputs, products, processes and materials. Examples hereof include the internet, networking and other technological changes that affect the way the organisation is operated. In this part of the analysis, the strategic planner can get a better comprehension of how well the executive teams are using the available technology to stay connected, but also how well they are using the technology to get more work done in less time, whilst still being able to balance the workload with leisure time.

## 2.2 *SWOT analysis*

According to Barney (1995), SWOT is a simple framework that points to the importance of both *internal* and *external* forces for the purpose of understanding the sources of competitive advantage. In such an analysis, the internal *strengths* and *weaknesses*, combined with the external *opportunities* and *threats* (hence the abbreviation SWOT), are considered. It is a preliminary analytical tool that must be supplemented with rigorous

competitive, resource, financial and organisational analysis, and help to decide whether the key problems facing an organisation revolve around a need to revise strategy, a need to improve strategy implementation, or both (Chermack and Kasshanna, 2007). SWOT analysis techniques are used in both the positioning-based and resource-based approaches to formulating strategy, however at different stages of the process.

- According to Thompson (1993), *strengths* are those elements of success such as a strong competitive position; while according to Groenewald et al. (2003) it is the resources and competencies that an organisation has that are better than those of its competitors, and according to Katsiolouides (2006) is the positive attributes or abilities unique to the organisation that in some way enhance the organisation's ability to achieve its objectives. Examples of strengths include excellent product quality, high service standards, availability of funds, highly skilled personnel and proprietary know-how.
- According to Groenewald et al. (2003) and Thompson (1993), *weaknesses* are those elements which prevent the organisation from achieving that competitive advantage. Examples of weaknesses include blocked channels or lack of communication within the organisation, a weak management team, bad financial management and untrained sales teams.
- According to De Kock (2008) and Groenewald et al. (2003), an *opportunity* is a major positive factor in the environment that puts an organisation in a better position to meet the needs of its customers than the position of its competitors. Examples of opportunities include government legislation about to be introduced that will enable additional product claims, new technology being developed that will mean a realignment of the market sector; and market vacated by an ineffective competitor.
- According to Groenewald et al. (2003), a *threat* is a major negative factor in the environment that puts an organisation in a weaker position than its competitors. Examples of threats include an economic recession, competitors can threaten to steal customer with better products or services, and political legislation may affect a firm's prospects through the threat of a ban on certain products or increase of import/export taxes.

### 2.3 Generic strategies

Porter's generic strategies consists of *product differentiation* and *cost leadership* (Korkmaz and Messner, 2008), while *focus* is also often considered an accepted strategy classification (Korkmaz and Messner, 2008). A study by Miller and Friesen (1986a) found that firms that show distinctive competencies in the areas of differentiation, cost leadership and focus dramatically outperformed all the others.

- The strategy of *differentiation* aims at creating a product or service that is somehow unique. This can be done through design or brand image, technology, customer service, or other attractive features. Many firms differentiate themselves along several dimensions for example by offering high quality and innovative products. The basic aim of differentiation is to create brand loyalty, and thus price inelasticity on the part of buyers. This can erect competitive barriers to entry, provide higher sales margins, and mitigate the power of buyers who lack acceptable substitute



products. The differentiation strategy must typically be backed up with costly activities such as extensive research, product design, and marketing expenditures (Miller and Friesen, 1986b).

- The strategy of *cost leadership* is to become the lowest cost producer in a specific industry. This usually involves the construction of efficient-scale facilities, rigorous pursuit of cost reductions from experience, tight cost and overhead control, avoidance of marginal customer accounts, and cost minimisation in areas like R&D, service, sales force and advertising (Porter, 1980). Cost leadership often entails large scale facilities and economies that constitute barriers to entry. The cost leadership strategy may require building market share via aggressive pricing to maximise economies of scale, designing products for ease of manufacturing, using state-of-the-art equipment, and pursuing technological (manufacturing) R&D initiatives (Miller and Friesen, 1986b).
- According to Porter (1980), the *focus* strategy rests on the premise that the firm is able to serve its narrow strategic target market more effectively or efficiently than competitors who are competing more broadly. The focus strategy can also be used to find neglected target markets – areas or customers for which conditions are the most favourable and competitors the weakest, but it typically involves a trade-off between profitability and sales volume (Miller and Friesen, 1986b). As a result, the firm achieves either differentiation from better meeting the needs of the particular target, lower costs in serving this target, or both.

### 3 Empirical results

The following section presents the results of the structured interviews with BAF Ltda's top management structure. The majority of the participants (80%) have more than ten years' management experience within BAF Ltda, with 40% also having between five and ten years of managerial experience at other companies. Furthermore, 40% have no experience outside the current firm. All the participants have degrees while 80% are also Brazilian registered auditors. The majority of 80% have been working within the consulting/auditing industry for more than ten years, with around 10% coming from an entirely different field. The majority of the participants (60%) agree that BAF Ltda is in fact conducting external environment analysis.

#### 3.1 PEST analysis

##### 3.1.1 Political environment

Figures 2 and 3 illustrate the data collected with regards to the political environment. With the, imminent Brazilian presidential elections at the time of the research, 60% of the participants expected Serra's government to be more of a threat, while 60% also thought that a Dilma's government might present BAF Ltda with more opportunities. The two major threats identified are the recent Brazilian merger of Terco (Grant Thornton's Brazilian member) and Ernst & Young (60% definitely rating) and the possibility of more stringent employment laws (80% most likely rating). The country is already crippled with tough employment laws, so although this rates as a very high threat, the possibility of the

laws becoming more stringent is low. The threat from the Terco merger, though, is more apparent, with the new, bigger Ernst & Young Terco firm being able to focus more on BAF Ltda's current high level clients.

Figure 2 Possible threats in the political environment for BAF Ltda

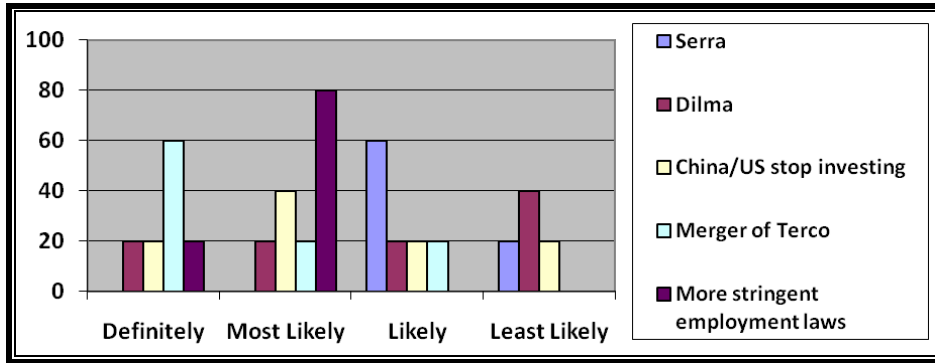
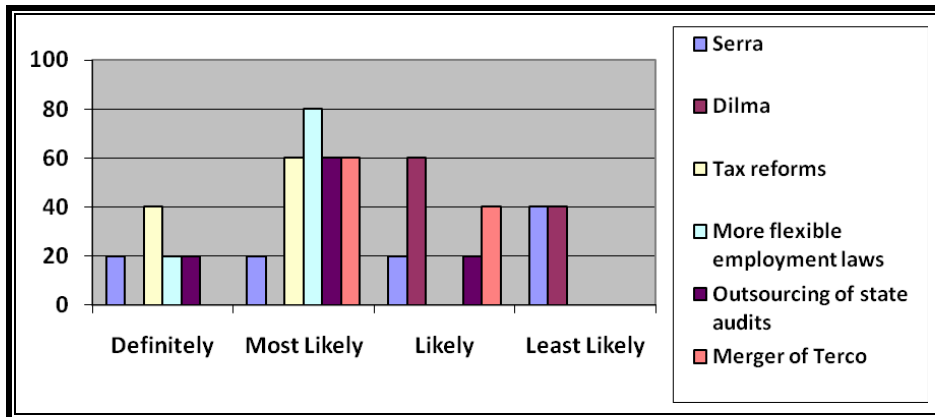


Figure 3 Possible opportunities in the political environment for BAF Ltda



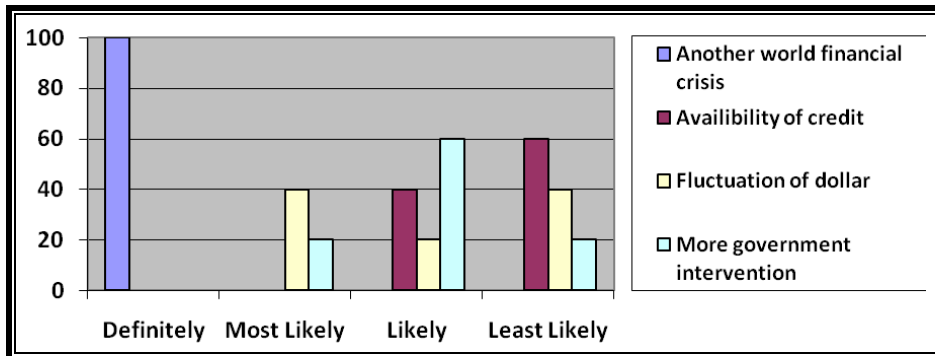
The best opportunities identified were possible tax reforms after the presidential elections (60% most likely rating and 40% definitely rating), more outsourcing of state audits to private auditing firms (60% most likely rating and 20% definitely rating), the merger of Terco (60% most likely rating) and more flexible employment laws (80% most likely and 20% definitely rating). These opportunities need to be understood in the broader perspective. For example, tax reforms have been promised since the 2002 elections, yet so far nothing has been done. The same goes for more flexible employment laws of which most laws are still from the 1940s. The outsourcings of state audits (government departments that contract private audit firms to do the audits) have been happening for the past couple of years; should the trend continue, it could create good opportunities for BAF Ltda. The merger of Terco presents BAF Ltda with some opportunities if they move fast to approach Terco's clients that were or still are unsatisfied with the merger.

### 3.1.2 Economic environment

All the participants expected the Brazilian economy to show a positive growth in the immediate future, while 60% expect the Brazilian Real currency to strengthen and 40% expect the currency to stay at the current average. The participants strongly agreed with the expectation for the unemployment rate to decrease over the next three years and for the inflation rate to either decrease (60%) or stay at current average (40%). This positive outlook is also apparent in local newspaper articles and when speaking to other executives from outside the firm. The majority of the participants (40% high impact and 40% low impact) agree that crime does have an effect on the economy; however, they explain that it depends on which business unit they are referring to. Rio de Janeiro and São Paulo is well known for its organised crime, and Rio in particular has a very high crime rate. This aspect plays a part particularly when foreign companies want to establish themselves in Brazil. The World Cup and Olympics are expected to have a high impact (80%) and if one contemplates the impact the 2010 World Cup had on South Africa, it is easy to agree with the choice of participants.

Figures 4 and 5 illustrate the threats and opportunities identified in the economic environment. The most probable threat would be another world financial crisis (100% definitely rating), as this negatively affects BAF Ltda's foreign clients. Brazil weathered the last financial crisis quite well, so the threat will not be so much with regards to BAF Ltda's local clients. The fluctuation of the dollar also poses a threat (40% most likely and 20% likely rating), however this again is only regarding BAF Ltda's foreign clients, which currently only makes up about 5% of their annual revenue.

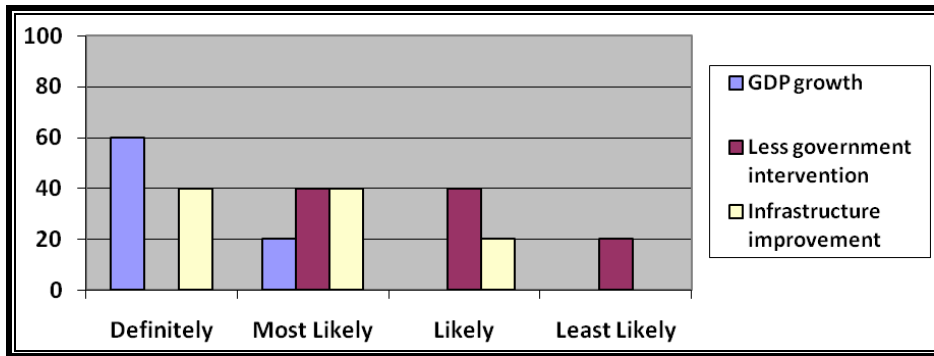
**Figure 4** Possible threats in the economic environment for BAF Ltda



The main opportunities identified were the growth in GDP (60% definitely and 40% most likely rating) and possible infrastructure improvements (40% definitely and 40% most likely rating). Less government intervention (40% most likely and 40% likely) is also seen as an opportunity, especially with the high levels of bureaucracy that is found in the sectors of the economy where the Brazilian government is strongly intervening. The GDP growth rate has been a very big factor for foreign firms coming into Brazil and also for national firms when deciding to invest in newer equipment or other financial and

operational investments. With the World Cup and the Olympics there have been many new developments regarding infrastructure, and although there are lots of fears for overspending and corruption, this opens up the way for BAF Ltda to audit these projects on behalf of the investors and the public. With BAF Ltda doing so much work across Brazil, the improvement of infrastructure will assist in lower travel costs and quicker travel times.

Figure 5 Possible opportunities in the economic environment for BAF Ltda

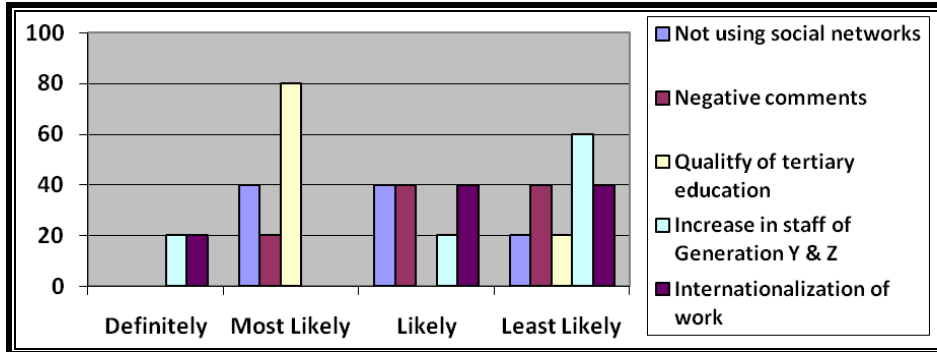


### 3.1.3 Social environment

60% of the participants indicated that the staff of BAF Ltda is very diverse. The same 60% responded that BAF Ltda is doing enough to improve the social culture within the firm. The actions that were explained by the participants as to what is being done to improve the social culture, though, are very limited. This includes things like putting up a monthly birthday calendar and having an end-of-year party. The 20% participants who stated that the personnel of BAF Ltda is not very diverse and that BAF Ltda is not doing enough to improve the culture, gave more in-depth explanations by stating that ‘there are no career plans or any kind of individual specific training/development programmes. The communication between the departments – and even between some individuals within departments – is dismal and there are no action plans to resolve such issues’.

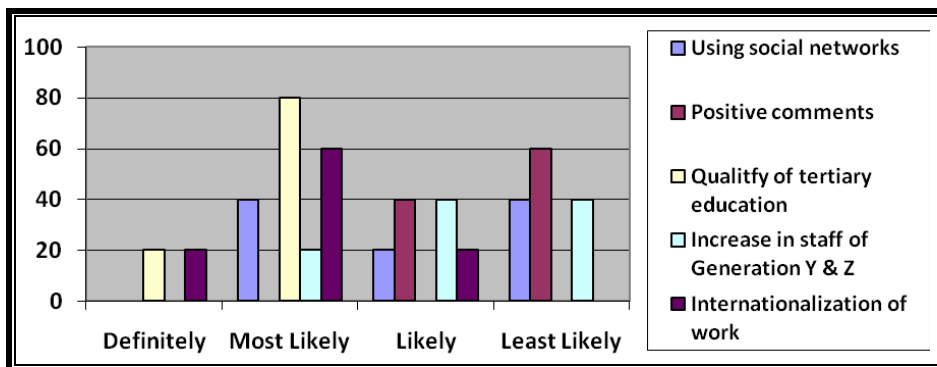
Figures 6 and 7 illustrate the threats and opportunities identified in the social environment. The most probable threat is a long term threat in the form of lower quality students that are being delivered by the current tertiary education system (80% most likely rating). Another probable threat is not making full use of social networks like LinkedIn, Twitter and Facebook (40% most likely and 40% likely). This is increased when combined with the current level of computer skills that the majority of the staff possess, which is below average. Internationalisation of work can also quickly turn into a threat due to only two people within the firm possessing advanced English skills and only five intermediate English skills. However, only 20% participant rated this threat as definitely and the rest as a likely (40%) and least likely (40%) threat.

**Figure 6** Possible threats in the social environment for BAF Ltda



Possible opportunities lie in more people getting access to higher education with the majority of the participants rating it as definitely (20%) and most likely (80%). As mentioned with the threats, the quality of the degrees might be questionable in some cases; however it still increases the pool of qualified professionals from which to choose. Internationalisation of work also has opportunities in getting staff into contact with different cultures and motivating them to improve their language skills. The majority of the participants rated this as definitely (20%) or most likely (60%). This opportunity will need more proactive management in preparing the staff on international standards (IFRS, USGAAP, Sarbanes Oxley) and also assisting them with improving their language skills. Using social networks as an advantage to the firm is becoming more of an issue and thus also an opportunity through the initiatives of the international group to which BAF Ltda belongs. Forty percent of the participants rated it as most likely, 20% as likely and 40% as least likely. Positive comments on social networks (40% likely rating and 60% least likely) and the increase of staff members from generation X and Y (20% likely, 40% likely and 40% least likely) also present some opportunities, however not as great as when compared to the other listed options.

**Figure 7** Possible opportunities in the social environment for BAF Ltda



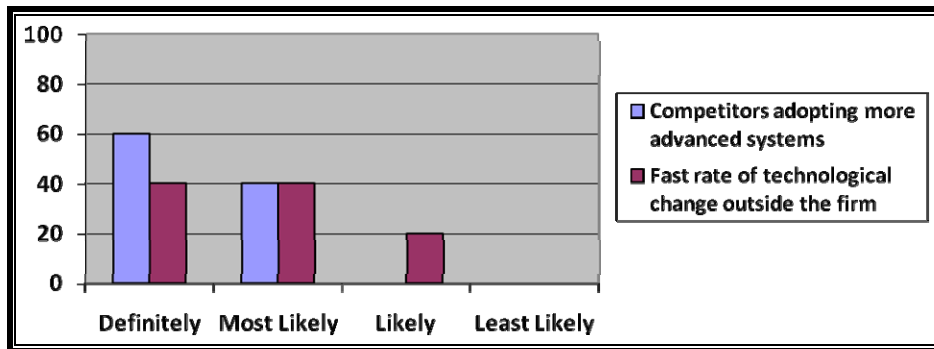
3.1.4 Technological environment

Out of the available technologies listed, BAF Ltda currently only uses office packages (100%) such as Microsoft Office, VOIP (40%) such as Skype and an internal database (100%). 60% of the participants listed that BAF Ltda uses accounting/auditing packages; however they were referring to the adaptation of the CCH auditing system that has not moved beyond the planning phase of the project since 2008 (when it was first decided to implement the software).

All of the participants (100%) agreed that BAF Ltda is not making use of the best technology available in any of the areas listed and all (100%) also agreed that it is not making the best use of technology as a whole. Eighty percent of the participants stated that keeping pace with technological developments is of great importance for the future of BAF Ltda. When comparing the three answers mentioned above, it is quite apparent what big threats and opportunities the technological environment holds for BAF Ltda.

Figures 8 and 9 illustrate the threats and opportunities identified in the technological environment. The two high level threats identified by the participants in the semi-structured interview both have rather high ratings. The threat of competitors adopting more advanced systems and thus becoming more cost effective or less prone to human error is rated as a definite threat by 60% of the participants and by 40% as a most likely threat. The fast rate of technological change, which from the previous paragraph answers is apparent that BAF Ltda is not keeping with, is rated as a definite threat by 40% participants, a most likely threat by 40% and a likely threat by 20%. In BAF Ltda’s sector, where paperless audits are becoming the norm, threats such as these will need to be handled in short time and with great care.

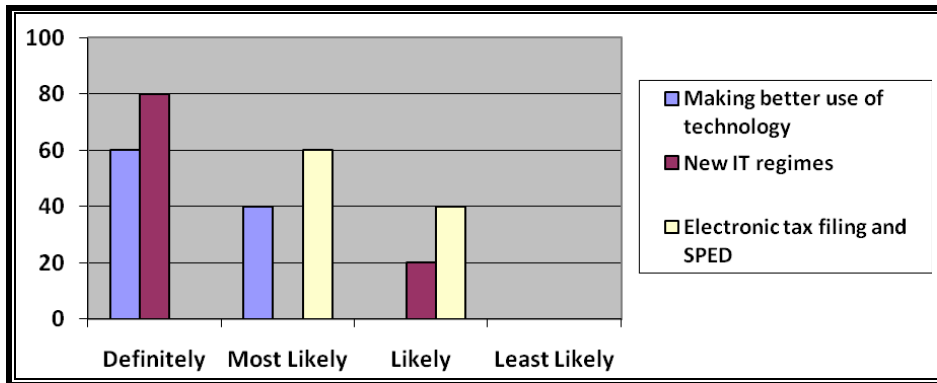
Figure 8 Possible threats in the technological environment for BAF Ltda



Opportunities identified include the better use of technology with a definite rating by 60% participants and most likely rating by 40%. As mentioned before, this is an area that will need special attention from the management team with regards to strategic planning. Another opportunity is the creation of new IT regimes, which received an 80% definite rating (four participants) and a 20% most likely rating. During 2008, BAF Ltda has created an IT auditing department with IT specialists in the special import/export tax regimes. Currently, they are the leader in this field in Brazil, and the development of new regimes by the government will further allow them to expand this department and their market share. Electronically filing personal and firm tax is also an opportunity (60% most likely and 40% likely) for BAF Ltda in that it makes it easier to audit, however they have

sold their accounting department in 2005, which would have been able to benefit more directly from the implementation of the above and SPED (an electronic invoicing system) in Brazil.

**Figure 9** Possible opportunities in the technological environment for BAF Ltda



### 3.2 SWOT analysis

Figure 10 presents the data collected with regards to the strengths of BAF Ltda. The flexibility and agility with which the firm has to take quick decisions through a small and fixed management team is rated as the greatest strength (80% first and 20% third), while a strong culture within the firm is rated as the least (40% fifth and 60% sixth).

**Figure 10** Possible strengths of BAF Ltda

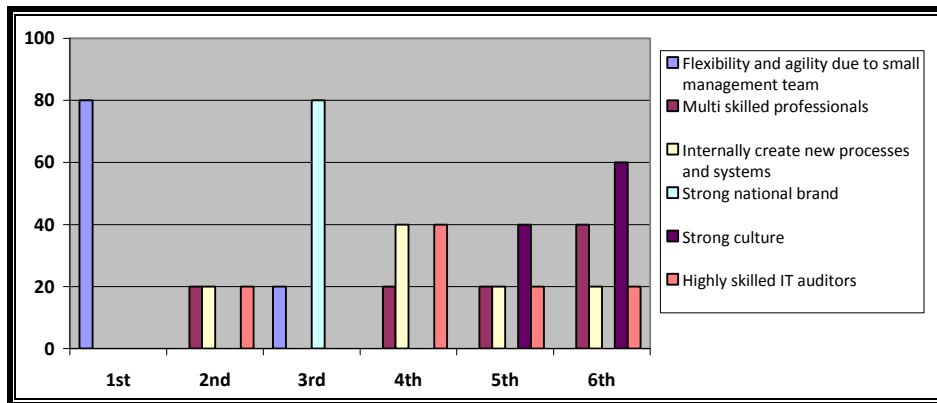


Figure 11 presents the data collected with regards to the weaknesses of BAF Ltda. The low skill level and qualifications of the workforce is rated as the greatest weakness (40% first, 40% second and 20% third) and the least is the loss of opportunities due to the fixed mindset of the small management team (20% first and 80% fifth).

Figure 11 Possible weaknesses of BAF Ltda

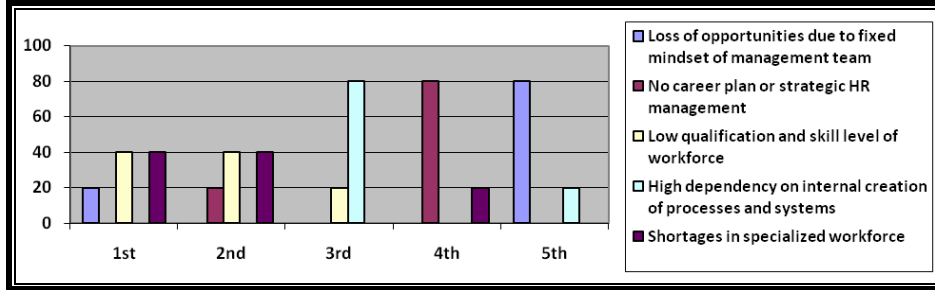


Figure 12 presents the data collected with regards to the opportunities of BAF Ltda. The biggest opportunities are the identification of new market niches (40% first, 20% second and 40% third) and making full use of technology (40% first, 40% second and 20% fifth). The least of the opportunities is tax and labour reforms with 60% of the participants rating it as seventh, 20% as third and 20% as fourth.

Figure 12 Possible opportunities of BAF Ltda

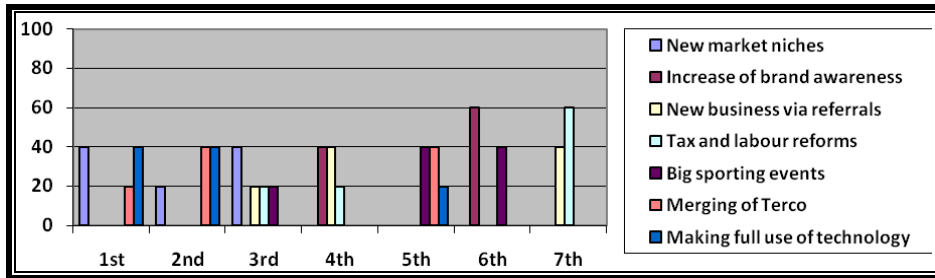
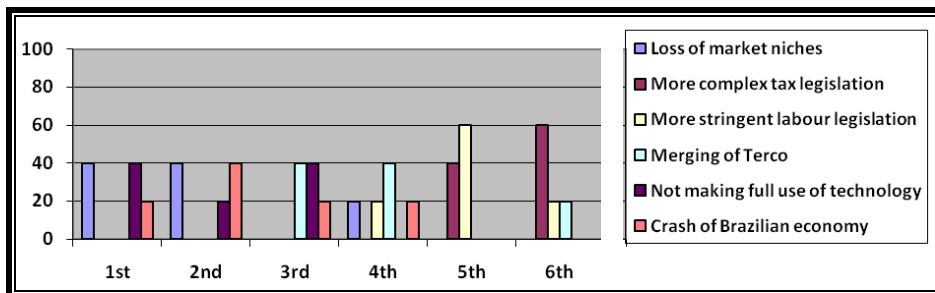


Figure 13 presents the data collected with regards to the threats to BAF Ltda. The greatest threat is the loss of current market niches like the IT auditing (40% first, 40% second and 20% fourth) and not making full use of technology (40% first, 20% second and 40% third). The lowest threat is the tax legislation becoming more complex after the elections, with 40% of the participants rating it as fifth and 60% rating it as sixth.

Figure 13 Possible threats to BAF Ltda

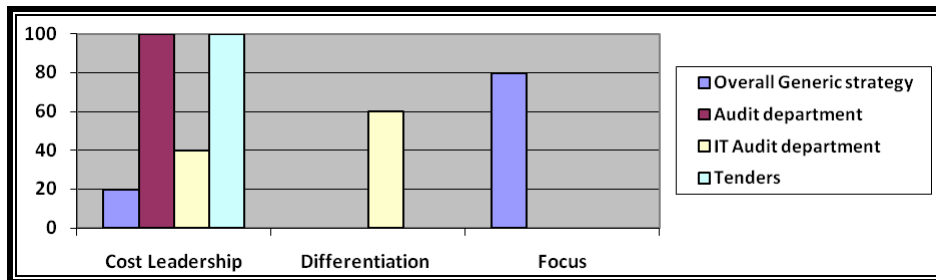




### 3.3 Generic strategies

Figure 14 presents the data collected with regards to the generic strategies for BAF Ltda. All participants agree that the cost leadership strategy is best suited for the audit department and the tenders department. The majority of the participants (80%) think that the overall strategy must be a focus strategy and 20% thinks it must be cost leadership. With the IT audit department the majority (60%) chose differentiation as the best strategy for the department, while the rest (40%) chose cost leadership.

**Figure 14** Generic strategies of BAF Ltda



## 4 Research summary and concluding discussion

The value of this research project can be found in the contribution it makes to available literature on the competitive environmental analysis of smaller auditing firms. Whereas much of the available SWOT- and PEST-based research consider large global auditing firms and the issues facing them, this article identified and considered issues closer to home in the context of smaller firms.

The research found that both the SWOT and PEST analyses are very subjective and this was clearly observable in the results of the study. The management team had varied responses on some issues that, if these planning tools were more objective, would have been much more similar. This is a problem when using tools such as SWOT and PEST, as they are only as good as the information that they contain. In companies such as BAF Ltda, where the culture does not always lend itself for open and honest discussion, it sometimes makes it difficult to get to the core of the issue and acquire the relevant information.

Via these analyses it was possible to identify some of the key strategic issues facing BAF Ltda and bring to the attention of the management team the discrepancies in some of their answers and thought patterns. The value of these issues are not when each of them are analysed individually, but rather when they are compared and analysed as a whole, as it is through the combination of all the information that trends can be identified and suitable strategies adopted in a timely fashion. The dedication of the management team of BAF Ltda to further analyse and address these issues and discrepancies is of extreme importance for the future success of the firm. During the course of the study, it was apparent that more attention will be given to this by the BAF Ltda management team.

The overall choice of the focus strategy seems to fit well with the results as identified within this chapter and lends itself to form a foundation for more advanced strategic planning by BAF Ltda in the future.

#### *4.1 Interpretation of results*

BAF Ltda is an audit firm that has weathered many business storms during its 45-year existence. It has an experienced management team with the majority of its management team members being with the firm for more than ten years. This amount of years together has shaped their way of thinking to become very similar, which could easily be seen when contrasted with the answers from the final subject of the five, which has less than five years of management experience within BAF Ltda, however more experience outside of the firm than the other four participants. What was found during the study was that this familiarity between the four longest standing members has created some substantial communication gaps, as with some decisions it is merely assumed that someone will take ownership of the project/decision, which in reality is not always the case.

From the threats and opportunities facing BAF Ltda, the most important strategic factor would seem to be the protecting of current market niches and also the entering of new market niches. Two developments that have a bit of both of these are:

- The merger of Terco and Ernst & Young, which could create both opportunities and threats, and will need a better structured strategic approach. BAF Ltda will need to implement a more customer-focused way of dealing with their current high-level clients, while at the same time positioning themselves to become the natural choice for Terco's clients who want to move away from the firm before the merger. BAF Ltda's major weakness of not having sufficiently qualified and skilled staff will, however, need to be addressed before they will be able to assume this role and the subsequent implementation of career plans and strategic HR management. The majority of Terco's clients are in the construction industry and this will be an excellent niche for BAF Ltda to enter, particularly with the participants expecting the Brazilian economy to continue growing and the World Cup and Olympics expected to have a big impact on the Brazilian economy.
- The outsourcing of state audits could be very lucrative for BAF Ltda in the future; however, these kinds of audits are normally scrutinised very carefully by the media and the state audit department, so it will need good planning and execution. These audits are normally sent out on a tender basis and this is where BAF Ltda can position itself better by implementing auditing software or packages and other technological improvements which will bring down costs and increase efficiency. The presidential elections could play a big part in whether more audits get contracted out or not, as Dilma's party looks much more favourably on the process than Serra's.

The firm also has a lot of work to do with regards to human resource management and making better use of technology. When combined, these two aspects could hamper virtually any strategic plan that is put together without resolving the two issues first. Furthermore, a change like that will need the full backing of the whole management team and will also need to be implemented at the top first. Cost savings by keeping salaries down must always be weighed against the time or productivity lost by having staff that

need more time and training to do what someone more skilled (and thus with a higher salary) can do from the outset.

The differentiation generic strategy, as chosen by the majority of the participants for the IT audit department, needs to be better understood and implemented as, even though the participants chose this strategy, they are currently still pursuing the cost leadership within this department. This department is a leader in its field and if more strategic thought is given to how to develop better and different services, then the department can continue to differentiate itself from the competitors and thus protect its niche.

#### *4.2 Conclusions and recommendations*

Based on the preceding results, certain conclusions can be drawn, including the following:

- The research has shown that although the external environment is complex and dynamic, numerous variables of the external environment have been identified and investigated in BAF Ltda's PEST analysis. Currently the firm does not have a dedicated function to evaluate the competitive environment on a regular basis.
- The research revealed that the firm's key strength is its quick decision-making capability via its relatively small top management team. This means they are able to quickly act on a decision and change the direction of the firm. Through the course of the research it has, however, become apparent that there exists a big gap between the making of a decision and its actual implementation.
- The research has shown that the main threats are the loss of market niches and that the firm is not making full use of technology. This threat becomes even more important when compared to the weakness of a low-skilled workforce that might not be able to quickly adapt to a new technologically advanced way of working. The main opportunities were shown as being able to identify new market niches and also to making better use of technology.
- The research has shown that firm management only recently recognised the importance of competitive environment analysis and will in the near future dedicate more of the management team's time to this function.
- The research has shown that the focus strategy is best suited for the firm and that the cost leadership strategy fits the audit and tenders best, while the differentiation strategy fits the IT audit department best.

Based on the aforementioned, the following recommendations are presented:

- A PEST and SWOT analysis should be conducted regularly by a dedicated team to ensure that the firm understands its competitive environment and adjusts its short and long term strategies accordingly.
- The above mentioned analyses should form part of a fully documented competitive analysis process, which in turn should form part of a fully documented strategic planning process.

- The firm needs to implement better human resource strategies and either start to develop the current staff to be prepared for future technological changes, or start to contract better skilled and highly qualified workers.
- The firm should think more strategically about how they can keep their current market niches and also how to identify future market niches. This also means that more time must be spent on evaluating strategies on how to enter these markets and also how to defend the current ones.
- The management team must choose a process/project owner each time a new strategic decision is made. That person must be responsible for implementing the change and seeing the project through to the end.
- The management team must better evaluate and act quicker on actions/projects that will assist in the better application of the chosen strategy for each department. An example here is the cost savings that can be made by making better use of technology with the tender and audit departments, where the cost leadership strategy has been identified as the principle strategy.

#### *4.3 Limitations of research*

The following shortcomings were identified during the research and should be kept in mind:

- The findings of this study were based on interviews conducted with representatives from the sampled case studies. As such the reader must be careful not to extrapolate the findings to the Brazilian audit industry in general.
- The knowledge of the participants about the external environment is questionable and there are also key differences in the knowledge and understanding of the participants on the internal environment.
- The external environment is constantly changing and it is difficult to measure all the variables that would influence the operations of BAF Ltda.
- There was difficulty in comparing and benchmarking BAF Ltda versus its competitors because of a lack of competitor information. The cost of obtaining such information would have been too substantial for a study of this size.

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