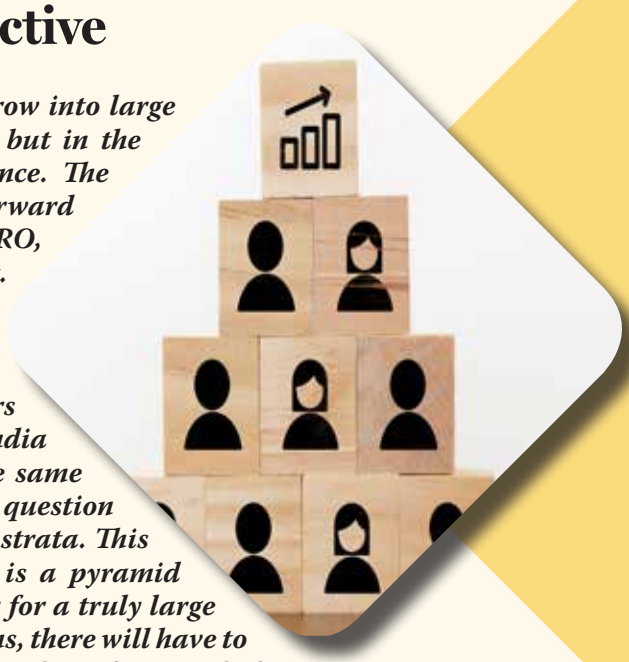
Capacity Building by Evolving Into Mid-Size Firms: An Analysis in Indian Perspective



There has been a strong desire that Indian firms grow into large firms that can have not just a national presence, but in the foreseeable future – even an international presence. The Indian economy has been taking enormous strides forward and today home-grown corporates like Infosys, WIPRO, Tatas, Birlas and others have a global footprint. The Indian accounting profession is a rich lode of talent and excellent technical expertise. However, seemingly there is not even a marginal player at the international level. Undoubtedly, our members are part of numerous global firms that operate in India – but a home grown firm / brand that reaches the same level is still highly desirable. Getting there is not a question of one or two firms suddenly leap frogging into that strata. This can happen in natural progression, only if there is a pyramid structure underlying the attempts to build capacity for a truly large firm. Thus, before we can have very large Indian firms, there will have to be numerous large firms, a much higher number of medium firms with the small firms forming the base of the pyramid. That is not the way that CA firms exist in India today. Read on…

To identify the specific problems faced by the smaller firms, and in what manner these need to be addressed in order to strengthen these firms; which are the source of income for the vast majority of practising chartered accountants, it is necessary to segregate them into some broad buckets. This is because, the problems faced by the smaller firms are quite distinct from the issues that concern the large and extremely large firms. But before we begin this process of categorisation, we need to be clear how one defines each category. There is no official categorisation of the firms and, therefore, this concept is quite subjective. For example, in towns such as Malegaon or Meerut, a firm having 6 partners may be considered large. In the metropolitan cities however, this may not even be considered to be mid-size. So for the purpose of this article, the following approach[1] has been adopted:

All proprietary firms and those having less than 4 partners	Proprietary & Ultra-small
Firms with 4 to 6 partners	Small
Firms having 7 to 10 partners	Medium
More than 10 Partners	Large
More than 20 Partners	Very Large

Here it must also be clarified that when we refer to capacity building – it does not mean just adding partners, CA employees or qualified personnel like valuers, corporate lawyers, etc. Capacity building as envisaged in this article (and in the ICAI's vision) includes the ability to have requisite infrastructure, knowledge base, training capabilities and manpower, backed by a scientific HR policy. It is not possible to evaluate all these characteristics in an article of this nature in the journal. Hence, as a rough and ready measure, the number of partners is taken as the basis of

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[1] The above grouping is of course my subjective view, keeping in mind the current objective of the classification.

classification. The caveat that this is only one of the indicators distinguishing, small, medium and large size firms must be kept in mind. Keeping in mind the above basis of classification, a look at the statistics in Table 1 in regard to CAs would indicate some important conclusions.

Number of Firms in 2008					Number of Firms in 2018				
No. of Partners	Total no.	No. of Members in the Firm	% of Members in such firms	Group wise total	No. of Partners	Total no.	No. of Members in the Firm	% of Members in such firms	Group wise total
1	32320	32320	44.72%	44.7%	1	53153	53153	41.14%	41.1%
2	7780	15560	21.53%		2	11937	23874	18.48%	
3	2780	8340	11.54%	33.1%	3	5342	16026	12.41%	30.9%
4	1099	4396	6.08%		4	2133	8532	6.60%	
5	592	2960	4.10%		5	1319	6595	5.11%	
6	322	1932	2.67%	12.9%	6	687	4122	3.19%	14.9%
7	240	1680	2.32%		7	463	3241	2.51%	
8	180	1440	1.99%		8	263	2104	1.63%	
9	109	981	1.36%		9	198	1782	1.38%	
10	70	700	0.97%	6.64%	10	154	1540	1.19%	6.71%
11 to 20 partners	148	1969	2.72%	2.72%	11 to 20 partners	291	3813	2.95%	2.95 %
More than 20				N.A.	> 20	51	4404	3.41%	3.41%

45640	72278	in 2008
No. of Firms	No. of Members	

75991	129186	in 2018
No. of Firms	No. of Members	

- An overwhelmingly large percentage of CA's practice as sole proprietors. 53153 members (41%) practice as sole proprietors.
- The percentage of CA firms with not more than 3 partners add a further 31% to the above.

Thus practically 3/4th of the members in practice are in Ultra-Small Practices. The next category (the Small Firms – i.e. 4 to 6 partners) constitute a further 15% of the firms of practitioners. Thus, 87% of the firms can be said to be Small Firms. The mid-size firms comprising of 7 to 10 Partners constitute around 7% of the membership in practice. **Firms having 11 to 20 partners Large Firms and firms having more than 20 - Very Large - constitute a further 6 % only**. The very large firms having more than 20 partners (Including LLPs) are just 51 in number and constitute 3.41 % of the total membership[1]. Thus, it is with the intention to facilitate the spirit of combination and capacity building in 89% of our firms (or in at least 74 %) that the ICAI has been making a huge effort.

More than a decade ago ICAI had identified that CA firms in India need to develop their capacities in multifarious ways in order to be equipped to at least retain ground or compete with the larger firms. In fact, in 2010 a committee to facilitate such capacity building and consolidation amongst the smaller firms was formed. The committee has taken numerous initiatives to try and spread this message amongst the members, particularly in the smaller cities and towns. Despite the above, the percentages in each of the categories mentioned above has not changed significantly over the past 20 years.

The increase over the last 10 years in firms having size of 4 to 10 partners is a nominal 2 % - and that too has come with the increasing awareness about the benefits of such firms for various empanelment's. A sizeable number of firms that have been added in this category (4 to 10 partners) thus fall in the "bank and government audit partnerships". These are not mid- size or large partnership firms in the true sense as considered in the following analysis. Many of the partners of such firms are for all practical purposes operating as independent profit centres in regard to the other incomes (such as tax practice, compliance, tax audits etc.) Therefore, it would be safe to assert that the 'real' growth in the small practitioners moving up the scale into a mid-size partnership firm will be much less than 2%. I do not wish to find fault with such firms. They are perfectly within the regulatory requirements, and they do serve the purpose for which they are formed. But since their objective is limited, they

[2] The very large firms would probably have an estimated 15 to 20 thousand CAs as employees or associates of such firms.

cannot mature into the 'mid-size practice' that we are considering in this article. These entities, therefore, are more in the nature of networks or alliances though having the legal structure of a midsize firm. If this number is added to the up to 3 partner professional firms – I expect that this number would be not less than 96% of the practicing CA's.

So should the smaller firms be looking for growing into larger entities because of a broad objective of ICAI to enable our members to improve their competitiveness and capacities? Surely, although such an objective may sound wonderful and idealistic. However, every member would eventually decide on whether to go for such combination and whether to invest in capacity building depending on what would be the benefit to him/her and their partners. Any accountant will look to what is the impact on the bottom-line. Therefore, it is important to consider what could be the benefits in such suggested combinations or organic growth through mergers, acquisitions and networks, and how larger may possibly be better. For enabling the readers to judge for themselves according to the unique situation of each member, a broad **SWOT analysis** of having a larger firm is given hereunder / Table 2:

Strength	Weakness
Greater Size giving greater – • Stability of clientele & revenues – since sources of income become broad-based. • Independence from client pressures • Specialisation - Ability to create verticals and subject focus – Today very difficult for one person to handle & remain updated on all subjects like Direct Tax, Indirect Tax, Audit – Statutory & internal etc. • Greater band width, more in-depth & updated knowledge • Partners Supplementing each other's strength. • Often partners can provide timely and painless correction where necessary – often such in-house consultation provides greater peace of mind. • Greater client confidence – that his work will always be attended to.	**Larger Size / More partners leads to** • Income for work that one Partner gets – being shared with others • Greater Size resulting in more administrative costs & co-ordination requirements • Loss of absolute control • Personal bickering or internal politics may arise - can sour relationships.
Opportunity	**Threat**
• Greater brand recognition with more social leveraging • Ability to Invest in emerging professional areas and in Technology. • Ability to have better staff • Gives overall stability for different sectors • Ability to enjoy fruits of labour by eventual encashment of goodwill. • More possibility for networking & higher social visibility and stature	• Possibility of losing own client to other partner who may later leave. • Submerging of individual identity.

The above analysis would clearly indicate that combination into a larger entity clearly has more advantages - provided of course the members concerned have the ambition and appetite for such growth.

Yet the table given above shows that the number of sole proprietor firms has declined negligibly (45 % to 41%). Virtually the same trend continues for every category of firms up to the 10 partner level where the reduction is less than 5%. Similarly, while the number of firms having 11 to 20 partners has grown in absolute terms from 1969 to 3813, on a percentage basis, the growth in such firms is only 0.3 %.

If the advantages in such growth is as clear as it appears from the above, what is preventing members from developing strategies to grow into the mid-size segment in a steady and organised manner. I believe that the major impediment is the fact that chartered accountants learn about taxation, auditing and even management principles as applicable to business entities but are seemingly lesser educated on the strategic aspects of practice development. As a result, while we feel competent to advise bigger organisations about line and staff functions, organograms and other principles derived from Peter Drucker and other management gurus, we are unable to formulate and implement strategies and management concepts for organisation and management of professional practice. Admittedly, there are limitations of what the ICAI can include in the syllabus. However, I believe that the rank and file of the profession and the large number of intelligent, ambitious and capable members entering the profession, need to be exposed to the potential that such strategic thinking can provide for growth to mid-size and large firms.

There is ample earning potential for the mid-size firms and despite this a huge number of chartered accountants continue to compete fiercely for the limited market of the low end (low revenue & low profit market) small business entities. What are the main impediments that have prevented or have been roadblocks to the evolution of the proprietary and small sized firms to the more broad-based, market friendly mid-size firms? Following major factors can be attributed to this situation:

a) **The attachment to / ego involved in the name.** Most often young members start off by using as their firm name, their own name or a combination of one or two names of partners. There is undoubtedly a sense of pride and achievement in having a firm carrying your name. At times if the second generation enters the firm of the father, the attachment to the name is even more, especially because clients identify with that name. However, if a firm of two or three family members, or a couple of sole proprietors having their firms in their own names see potential in combining with a few others, this attachment to the name will have to give way to more practical considerations of future revenues. Besides, the current trend of having a combination of initials could help achieve this. A few alphabets can represent the names of even 6 to 8 partners; enabling each of the persons in the firm to identify with the firm name and at the same time ensure that no partner's name would dominate over the other. Frankly this is suggested only as a via media, because in fact it would be much more advantageous to adopt the best-known name because ultimately what you professionally achieve is far more important than the name that appears on the letter-head. It is instructive to remember that one of the best-known brands in the world (Google) was not the name intended to be adopted by the promoters of that company. It was a misspelling of the word 'Googol' but that has not prevented the company from being one of the highest earning corporates in the world. So, remember, the name does not matter, it is the services you render, the reputation, goodwill and revenues that you earn that make the difference. Any professional wishing to move up the ladder from a proprietary /small firm to a mid-size to large firm will, therefore, have to be willing to sacrifice this attachment/ ego in order to take the first step.

b) **The fear of loss of independence**. Most sole proprietors and other family firms feel that they would not like to be answerable to any third person about use of their

professional time, their priorities or their functioning. There is generally the apprehension that once other non-related / outsiders are taken on as partners, they may eventually question other partners about various aspects of the practice and the time utilisation. It is apprehended that this would reduce their independence, and, therefore, the incremental revenue is not worth this botheration. To a certain extent, the formation of a larger firm would undoubtedly result in some form of accountability being applied to each partner. However, this is not a severe constraint and to a certain extent such accountability is good for all concerned. This introduces a certain discipline that fosters better professional growth. This can be illustrated very simply by referring to the institution of marriage. It is an accepted fact that in today's world, after marriage each person is accountable to his/her spouse. While we may make innumerable jokes about this subject, this fact of accountability has not resulted in any decline in the number of marriages taking place. That is because the benefits far outweigh the limited loss of independence. Undoubtedly, late-night parties and irresponsible spending do get curtailed, but this is all for the better. The same principle applies in the case of formation of larger partnerships. Certain accommodation and adjustment of lifestyle / workstyle is required. However, it is wrong to presume that such adjustments are always troublesome or detrimental.

c) The apprehension that upon admission of partners, a part of the **income may have to be surrendered to the other partner**. This fear is entirely unfounded. Any attempt to come together would always be founded on the concept of synergy and better utilisation of professional capabilities. As such while there may be periodic fluctuations due to the difference in nature of the incomes of the persons coming together, by and large the pie to be shared would get bigger and the individual income would not get smaller in the long run. Rather, the stability and smoothening of the income curve that such partnerships provide is an incidental benefit that would flow from a more broad-based mid-size partnership firm.

d) **Difficulty in determining fair profit-sharing / remuneration basis amongst partners**. Undoubtedly, this is a sensitive and difficult subject. However, as chartered accountants, we, more than any other professional, should be capable of identifying a fair formula for distribution. Besides, while the fundamental concept or basis of sharing can be agreed upon; actual revenues from various areas of professional work, the amount of time devoted by each partner can be factored in to determine a suitable and nuanced profit-sharing approach.

e) **Fear of Losing clients to your partner.** A true partnership must be founded on a certain amount of trust and belief in the other person's ethics. If one wants to grow and perceives benefit from such steps, a more aggressive approach whereby one looks at the benefits rather than the pitfalls is essential. Besides, the other side of the coin is that by entering into a larger partnership, the possibility of acquiring more clients is equally higher and, therefore, such negative thinking of fear of losing clients is entirely unwarranted.

The above are some of the common apprehensions that have been expressed by persons who are considering growth by combination, acquisition or merger etc. Each member will have to judge his own facts and circumstances whether the advantages mentioned above and many other spin-off benefits such as the opportunity to grow as an individual outweigh the constraints of small size. There is no one path to success, and each person has to evaluate the plan of action that is best suited to his/her circumstances, nature, ambition and risk appetite. Therefore, this decision has to be taken consciously and to fail to consider such options is to let slip an opportunity that may be beckoning. There is indeed a huge potential for the mid-size firms. ■