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AUDITOR CONCENTRATION AND MARKET SHARES IN THE US: 1988–1999 A DESCRIPTIVE NOTE

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This paper examines from a historical perspective the effects of the Big Eight and Big Six accounting firm mergers on concentration measures and market share percentages of major accounting firms in the US large company audit market. Concentration ratios and Herfindahl indices reflect an increasingly concentrated audit market, though individual firms differ in their success at capturing market shares in the three exchanges examined, as well as in their ability to capture newly listed companies or companies switching auditors over the 1988 to 1999 period.

INTRODUCTION

The 1990s were characterized by unprecedented merger activity throughout the global economy. As mergers increase, so too does governmental concern regarding anti-trust issues. In the December 1999 issue of the *Journal of Accountancy*, Jim Romeo discussed corporate mergers in the US, and some of the issues focused on by regulators. Romeo noted that an important consideration is that 'the market is not concentrated after the merger' (p. 60). He further explained that 'to determine if a merged company will have excessive market power, the increase of market concentration must be measured' (Romeo, 1999, p. 62). Similarly, Nobel Prize economist George Stigler wrote: 'The purpose of a measure of concentration is to predict the

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extent of the departure of price (or alternatively, of rate of return) from the competitive level' (seeStigler, 1968, p. 30). To provide some insight into this assessment, this paper examines current auditor concentration within the US, putting it in a historical context.

When four Big Eight accounting firms merged in 1989, concerns were raised about the increased level of accounting/auditor concentration. Apprehension arose again in 1997, when two of the resulting Big Six accounting firms announced their merger (effective in 1998), creating the Big Five. The *Financial Times* in an editorial (Consolidating Accounts, 1997, p. 13) wrote: 'Not only is this undesirable on competitive grounds; it will also allow the merged firm to exercise an unhealthy degree of influence over the standards and practices of the profession as a whole'.

This paper updates and expands upon prior research by investigating the effects of the 1989 and 1998 accounting firm mergers on the concentration within the market for audit services in the US. To investigate such effects, concentration ratios and Herfindahl indices are developed. Additionally, the impact on the market shares of the merged firms is considered. In this respect, we are motivated by the 1985 Mueller study of 1000 companies in which he concluded that merged companies did not necessarily increase their market shares when compared to companies that did not merge. Although mergers can have an immediate effect on measures of auditor concentration and market shares, over time there are confounding factors that can alter the consequences of such mergers (Beattie & Fearnley, 1994, pp. 303–304). To help isolate such factors, the success of major firms in securing clients as auditor switches and companies entering the market is examined. The paper concludes with a discussion of other factors that may influence the competitive outcomes of the mergers.

THE STUDY AND METHODOLOGY

Auditor concentration literature

To put our study in context, we first describe some prior research on the US audit market. Zeff & Fossum (1967) examined audit clients listed in the *Fortune Directory*. Their study was replicated by Rhode *et al.* (1974), Schiff & Fried (1976), and Dopuch & Simunic (1980). Campbell & McNiel (1985) examined *Fortune's* listed companies and questioned whether high market concentration was the result of lack of competition. Eichenseher & Danos (1981) posited and tested a concentration model against auditor concentration in 54 US industries. Danos & Eichenseher (1982) examined changes in audit market shares in 33 industries and in a later study (1986) found the market competitive for non-regulated companies. McConnell (1984) examined auditor changes for the New York Stock Exchange (NYSE), American Stock Exchange (AMEX), and the Over the Counter (NASDAQ) Market and concluded that while the Big Eight had increased