

MASTER'S THESIS

Course code: BE304E Candidate Number: 4,9

Careful Digitalization: Service Innovation in Audit
Small and Medium Practices in Pakistan

Date: 25 May 2021

Total number of pages: 82

Preface

This master thesis is submitted as a final step to acquire our master's degree in MSc in Business at Nord University. The dissertation is written jointly, over one semester and amounts to 30 credits for each of us. Theory, previous research, and external views are used for the dissertation's information basis. The topic we chose for our research is service innovation in small and medium auditing practices in Pakistan. We believe that audit industry differs from other industries where an increasing technology development among clients and a change in competitive conditions drive the auditing industry to service innovation. But service innovation in small and medium audit firms is still understudied. We therefore believe that the theme is relevant and there is also demand for this study.

We would like to thank our skilled supervisor, Ms. Nadezda Nazarova for good advice, support, and follow-up along the way in the writing process of this master thesis. Her rich feedback and constructive ideas throughout the entire process, and our discussion on the subject is of immense value. Her support and engagement in our work has been of a great inspiration.

We would also like to extend our gratitude to Professor Anatoli Bourmistrov and other members of TRANSACT project for their valuable feedback, input, and encouragement.

We would also like to thank all the informants for setting aside time for interviews from their busy schedule, and to be adaptable when the interview had to be conducted telephonically. Their experience and expertise have given us unbelievably valuable insight into the auditing industry's practices. We hope that the master thesis will be engaging, and that it provides knowledge and understanding of service innovation in the auditing small and medium practices in the developing economy.

Bodø, May 2021

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Abstract

We want to provide empirical evidence about the phenomenon of service innovation in small and medium sized audit practices (SMPs) in Pakistan. For study service innovation in details, qualitative approach was used, and data was collected through ten (10) semi-structured interviews from the partners or managers of small and medium sized audit firms those serve small enterprises in Pakistan. This master thesis presents that SMPs in Pakistan perceive service innovation as one-window opportunity to make their survival in the market. This study supports five facilitating factors i.e., technology, human capital, clients' demands, regulators compliance pressure and strong relationship with clients, towards service innovation in the audit industry. SMPs use ad hoc process for developing service innovation. Empirical evidence supports the view that human capital is a powering factor for service innovation in SMPs and mobilizes the other factors and resources such as technology and relationship with clients more efficiently to generate service innovation in audit firms. Utilization of existing technology in its entirety is the best course of action for small firms instead of rushing towards advanced technology which is incompatible with the market's need. This study focuses on one geographical area – Pakistan, therefore results may not be valid for other regions or markets and cannot be globally generalized. Further, SMPs in the developing economy are using available digitalization very carefully and smartly as they are exploiting the technological tools as per market's needs. This study contributes to the literature that service innovation is still possible within small and medium sized audit firms in developing economies where resources are limited while pressure is equally high, even without being technologically advanced.

List of Abbreviations

Abbreviations	Stand for
SMPs	Small and Medium Practices
SMEs	Small and Medium Enterprises
HR	Human Resource
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
ICAP	Institute of Chartered Accountants of Pakistan
QCR	Quality Control Review
SECP	Security Exchange Commission of Pakistan
CPA	Certified Public Accountant
AI	Artificial Intelligence
RPA	Robotic Process Automation
ERP	Enterprise Resource Planning
IAASB	International Auditing and Assurance Standards Board
USD	United States Dollar
PKR	Pakistani Rupee
CA	Chartered Accountant
CAATTs	Computer Assisted Audit Tools and Techniques
SBP	State Bank of Pakistan
IT	Information Technology
BPO	Business Process Outsourcing
FBR	Federal Board of Revenue
NTN	National Tax Number
FATF	Financial Action Task Force

Summary

Due to digitization and advancement in technologies, firms are changing their ways of doing business and innovative processes & services are being introduced in the entire world to get competitive advantage. Developed economies (e.g USA and Norway etc.) are more proactive in technology so firms and audit clients are considered comfortable with the adoption of new technological tools quickly by updating themselves. Most of things in the developed countries are around the technology and modern technology is adopted earlier than developing economies. Further, Big 4 audit firms have access to technological resources due to international affiliations with the top audit firms in the world.

On the other hand, where the small and medium sized audit firms in the developing countries like Pakistan are lack of financial and technological resources and their clients are not adoptive to technologies due to less awareness in the market. So, we want to study how audit small and medium practices (SMPs) in Pakistan create service innovation in the absence of technological resources. In order to study the phenomena of Service Innovation and help to fill the research gap, our problem statement is as follows:

“How and why service innovation is organized in small and medium audit practices in Pakistan?”

Through this study we want to explore the importance of service innovation for small and medium audit firms and how they develop such new services and, what key factors facilitate them to create service innovation. To understand the service innovation in these firms, we build on relevant literature within the field of auditing, service innovation, and social capital theory for innovation.

To study service innovation in details in SMPs, we chose qualitative approach with semi-structured interviews as most appropriate research method. We conducted interviews with ten informants from Pakistani audit firms who have relevant experience in the audit industry. The quality of the research has been discussed based on the concepts of credibility, transferability, reliability, and verifiability.

Main findings show that SMPs are more interested in service innovation than external audit services. Small and medium audit firms are registered primarily to provide external audit services to clients whereas they are not able to get enough audit clients from the market

because of regulators enabling big firms to seize more audit clients. If SMPs cannot create new services from the market, they may attract their demise. SMPs generate service innovation to succeed by meeting customers' demands through efficient utilization of employees' skills, knowledge, and expertise. Key management in SMPs are pursuing an entrepreneurship approach and thinking out of the box to utilize business opportunities irrespective of core accounting and auditing related field. SMPs in Pakistan are balancing both internal and external pressures with the ultimate objective toward survival in the market.

The other important findings indicate that SMPs believe more in their human capital than advanced technology. They think that technology only assist them to handle different assignments, but new service ideas and new projects are being initiated by the competent people at on-going basis. Human capital is in better position to decide which technological tools and type of technology is more effective for the firms to implement during their business processes and operations to create service innovation. Partners and employees of small and medium audit firms are closer to their clients due to their strong relationship, and they exploit relational capital quite well to understand the technological and other business needs of the clients. This indicates that human capital in SMPs is seemed to be so important as to be indispensable in responding to the environmental pressures exerted upon them.

Our analysis shows that auditing is still a manual process in SMPs and these audit firms have not adopted computerized auditing tools and techniques. Main reason to non-adoption of audit software is considered few numbers of small and less complicated audit clients. Other reasons are availability of cheap labor at SMPs' disposal in the developing economy and clients' manual or hard form records of clients. Auditors in SMPs have exceptional command in easily available MS Excel software that they are performing audit programs and many kinds of analytics in this software and their competencies and skills to utilize the software make the potential difference. It might be the case that being technological proactive in adopting advanced digitalization can be challenging and may not necessarily be the best option for SMPs to treat their customers.

Our empirical data indicates that SMPs are utilizing the existing technology exceptionally well and fulfilling the needs of the customers satisfactorily with available technology without any urgent demand for latest technology. SMPs are focusing more on international business and outsourcing services owing to efficient utilization of digitalization. Service

innovation facilitates necessary adaptive changes to the environment and innovations in service firms primarily do not follow and go after technological imperative. SMPs are neither much deficient in technology nor on the forefronts in technology so they are using the technology very carefully and smartly to create service innovation. Further, SMPs understand when they feel indispensable pressure regarding adoption of innovative technology from their clients in the soon future, they will adopt it quickly, until use of existing technology in its entirety is more prudent course of action.

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1.0 Introduction

Service innovation is considered vital for modern businesses. The ability of firms to implement service innovations has been very much associated with their digitalization ability to innovate and literature is mostly based on service innovation that is technological-driven innovation rather than other forms of soft innovation (Stoneman, 2010; Teece, 2010). Services sector generates more than 70% of the world GDP (Gross Domestic Product) (Chen et al., 2016) as compared to new product development (Tajeddini et al., 2020). Innovation in services has resulted in higher level of expansion and growth dynamically in economic activities over the past few decades (Daazenko & Grönquist, 2016; Jaaron & Blackhouse, 2018; Singh et al., 2020). To sustain and maintain competitive advantage in the market, companies are required to innovate continually their services processes and offerings (Lestari et al., 2020; McDermott & Prajogo, 2012).

Economic and social environment has changed prominently, including regulations, progress of technology and changing ways of communication. The emergence led to the introduction of the concept “Service Innovation” in 1986 (Barras, 1986). The innovative strategies in the service industry have become more essential to understand the changing needs of the customers and later to fulfill their demands competitively. Now clients are expecting and demanding for more quality services and value-addition in the competitive world. Several studies show that firms must innovate in response to customers' changing demands, to take advantage of opportunities in technology and market change (Baregheh et al., 2009). Inability to radically adapt to changes in the environment is also designated as an important explanation for why businesses do not survive longer than 30 years on average (Hillestad et al., 2014). Consequently, service innovation has emerged as an important driver and research area for survival in the business competition (Kaawaase et al., 2019).

Since the introduction of the term service innovation and its related concept, it has been the subject of growing interest, both in academia and as a framework for business development (Daazenko & Grönquist, 2016). Attempts have been made to develop a systematic framework adapted to the service innovation. These frameworks have been unsystematic, due to various processes for service innovation in companies (Breidbach et al., 2013). Hinings et al. (2015) believe that there have been few studies which discuss innovation in professional service companies, compared to other sectors. Information systems and digitalization has been considered as strategic resources for value creation, which can make ways for innovation. Research in service innovation is considered incredibly significant by scholars

due to much wealth generated by service sector in both developed countries and emerging economies but surprisingly researchers do not give much attention to service innovation in Asian markets, despite the facts that some of emerging economies are proliferating and may be among the world's strong economies (Thakur & Hale, 2013).

Auditing companies are classified as professional service companies, as they have enhanced knowledge intensity, competent workforce, and low capital intensity (Muller & Doloreux, 2007; Nordenflycht, 2010; Tomo et al., 2019). Nevertheless, audit firms have several characteristics that distinguish these firms from other professional service companies. In the digital world, the rules for interacting with the customers during services are also changing greatly. To retain and attract new customers, it is therefore critical that companies recognize and adapt to the new dynamics. In practice, this means that you must drive to a greater extent with customer engagement and loyalty, and adapt businesses to the changing customers (Deloitte, 2013). Blackburn & Jarvis (2010) claim that there is a lack of studies which focuses exclusively on small and medium sized auditing firms. Small and medium audit practices (SMPs) are an important part of the audit industry and the audit profession, as they make up most auditing practices worldwide. The contribution of SMPs in emerging countries cannot be undervalued as they do not only create employment opportunities but also a key source of support and advice to bulk of small and medium enterprises in the economy (Thakur & Hale, 2013). It is still limited knowledge of how they respond to challenges, and especially how they adapt their strategy, organizational structure, and practices (Blackburn and Jarvis, 2010), and less literature was found how small audit firms survive in the emerging economies.

A survey by IFAC Global (2018) shows, for example, that 38% of small and medium-sized auditing firms views technological development as a significant challenge. The report further shows that as many as 78% of the sample believe their role in a small business will change the next five years because of modern technology that challenges traditional accounting and financial roles. According to IFAC report (IFAC Global, 2018), 86% of the SMPs services are advisory services other than traditional services of SMPs. Top services are corporate advisory, management accounting, restructuring and HR policies as per mentioned report. SMPs (small and medium practices) audit firms, being knowledge intensive service firms, provide guidance to clients through better solutions for their problems.

Traditionally, professional service companies have offered services where they have relied on their own expertise and asymmetric control in customer relations. Technology has however, given knowledgeable and well-informed customers the opportunity not to be passive

longer. This has created a shift in customers' expectations and engagement in the customer relationship (Hinings et al., 2015). Since 1974, there has been talk of an expectation gap in the auditing industry, both between the auditor and the users of financial information, and between accountant and the standard setters (Franzel, 2016; Porter, 1993). Fjørtoft (2018) argues that audit firms' business model is positioned for digital disruption. He believes that the way businesses are organized presents challenges as the world changes more fundamentally and the expectation gap is widening. This makes it important to understand the gap between what the user of the financial information wants and needs from audit firms, and what the firms contribute (Fjørtoft, 2018; Rozario, 2019). The role of accounting and auditing SMPs is considered crucial for SMEs by providing them required quality services.

1.1 Purpose and Research Problem

Due to digitization and advancement in technologies, firms are changing their ways of doing business and innovative processes & services are being introduced in the entire world to get competitive advantage. Norway being developed country is perceived more proactive in technology, so companies and audit clients are considered comfortable with the adoption of new technological tools quickly by updating themselves. We assume this should be the case with small and medium audit firms in Norway that they are utilizing technologies very well and their clients have maintained their business processes aligned with latest technologies. Further, Norwegians SMPs and their clients are not short of resources, and it may be believed that they are using latest technologies in their business to create service innovation. Most of things in the developed countries are around the technology and modern technology is treated like fashion to adopt earlier than others. Further, Big 4 audit firms have access to technological resources due to international affiliations with the top audit firms in the world.

On the other hand, where the SMPs in the developing countries like Pakistan are lack of financial and technological resources and their clients are not adoptive to technologies due to less awareness in the market. So here questions rise, how SMPs in Pakistan create service innovation if they are not much technology- driven? So, to study the phenomena of Service Innovation and to fill the study gap, we want to study importance of service innovation for small and medium sized audit firms in Pakistan, how these firms think about service innovation being part of a developing country.

Our motivation for writing about service innovation in the auditing industry is based upon our interest in the topic and particularly due to less research on SMPs and knowledge-based

services firms in the industry. If auditing firms do not adapt timely to their customer's changing requirements, the clients may consider changing or leaving their firms. Firms should better leverage their relationships with customers by extending new and better services to their existing clients and / or attracting new markets.

Further, we want to help fill the research gap regarding how these small and medium sized audit firms develop the service innovation. This study can also highlight different key factors including digitalization required by SMPs in Pakistan which can help SMPs to accomplish the customers' needs efficiently and effectively, resultantly gap between SMPs current services and customer's desired services may be reduced after effective integration of key resources with other vital factors. There is a demand for more empirical studies that can increase the understanding of service innovation in the auditing industry. Based on this, we have designed the following problem:

“How and why service innovation is organized in small and medium auditing practices in Pakistan”?

Big audit firms have better conditions and resources for engaging in service innovation, where it is often expected that the other auditing firms have not reached equally to big firms, may be due to less technological development and shortage of competent staff and other resources. Service innovation is nevertheless something they eventually should decide on to, by considering customer's innovated needs with the emergence of modern technology. Research in this area is also concentrated on the largest auditing firms, and to our knowledge there is limited research on how small and medium-sized auditing firms create service innovation and why it is important for them. However, the innovation concept in the service industry and particularly in the accounting and auditing firms is understudied. This is also supported by Blackburn & Jarvis (2010) who claim there is a lack of studies which focuses exclusively on small and medium sized auditing companies.

1.2 Research Questions

To answer the above-mentioned main problem statement, we have two sub-questions / research questions:

- 1) Why service innovation is important for small and medium sized audit firms and how they develop new services?
- 2) What are the factors that facilitate service innovation in small and medium sized audit firms?

In this thesis, we focus exclusively on small and medium sized private audit firms in Pakistan. Collected data reflects auditors' perspective and not of clients. By SMPs we mean audit firms that are not part of big 4 audit firms and those just behind in terms of size often referred to as "Small and medium audit practices (SMPs)". Some important characteristics of SMPs are that they have few employees and their customer portfolio consist of small and medium sized enterprises (SMEs) and non-listed clients.

1.3 Structure of the Thesis

The thesis is divided into six main chapters. In the introduction chapter, the background and purpose of the thesis, problem, and associated research questions are mentioned. In chapter 2, the theoretical frame of reference is subdivided into two parts. First part consists of literature review about auditing and service innovation, whereas in the second part, theories and factors facilitating service innovation are explained.

In chapter 3, we shall explain our selection of research method and procedures we have used. The research method contains data collection, interview guide and selection of informants. At the end of this chapter, we assess the quality of the survey through evaluation of the concept's credibility, transferability, reliability, and verifiability. Chapter 4 presents the empirical findings, and chapter 5 consists of analysis of our findings against theoretical frame reference. In chapter 6, we conclude with most important findings, and limitation and further research.

02. Theoretical Frame of References

This chapter contains literature review about auditing, service innovation and service innovation process. Social capital theory of innovation was considered for this research study. Then, literature review about important factors facilitating to service innovation has been written in this chapter.

2.1 Auditing and Service Innovation

In this portion, we will highlight the important literature about auditing, service innovation and service innovation processes.

2.1.1 Auditing

According to Power (1997), auditing is about showing completeness, accuracy and validity of transactions that make up the annual accounts. At the same time, he claims that it can be difficult to give a concrete definition of what auditing is, and that existing definitions are often an attempt to describe and explain what auditing can be. According to Gulden (2015), external auditing can be described as an examination of the information a company provides to the outside world. The main purpose of the auditor's job is to increase the intended users' trust in a company's accounts by obtaining evidence with a reasonable degree of certainty and to confirm that the company's financial information does not contain significant misinformation (Gulden, 2015). Varci (2013) similarly explains that auditor's task is to examine and determine the validity of the company information using professional skepticism, where it implies that the auditor acts with that information in mind that management can be misleading. The auditor therefore plays a significant role when it comes to maintain the credibility of the accounts (IAASB, 2016).

The term audit quality may be described as market assessed joint probability about an auditor that he / she discovers a non-compliance and violation in the customer's accounting system and disclose and report the violation (DeAngelo, 1981). Audit excellence and quality is consequently a function of the auditor's independence and competence. Sirois et al. (2016) also point out differences in the audit firms' investment strategies in audit technology. According to the authors, the large auditing companies invest more in auditing technology than the small companies because of pursuing a differentiation strategy. A counterargument would be that everyone in the auditing companies is faced with the same regulatory and professional standards, which means that the individual company is required to comply with a certain level of quality (Lawrence et al., 2011).

Small audit firms are also believed to have superior knowledge of local markets and a better relation to their customers (Louis, 2005), which may put them in a better position to detect irregularities (Lawrence et al., 2011). This is also supported by Boone et al. (2000) who claim that small auditing companies typically have a more personal relationship with their clients than the large audit firms, because the auditor often takes on a more confidential and consulting role with their customers.

Pakistan is a nation with custom-based law, having acquired International Financial Reporting Standards (IFRS) after its declaration. Analysts argued that Pakistan exhibits traits of common law nations, which have less developed stock market, more dependence on banks and financial organizations for financing the debts, for minority investors' poor shareholder insurance, and complete possession influenced by private corporations, and it is noticed lower quality of accounting activities and transparency (Ashraf & Ghani, 2005). Implementation systems are commonly viewed as feeble in Pakistan. In the non-existence of powerful implementation systems, accounting standards cannot accomplish their impulsive goal of creating clear and dependable financial reports. Further, non-existence of strong implementation systems alongside failure of law brings down the interest for achieving higher audit quality in Pakistan (Sheikh & Siddiqui, 2020).

2.1.2 Service Innovation

Service can be defined as delivery of support, value or utility, and expertise, experience, or other intellectual subject, and most of the utility is non-physical instead of tangible product (DISR, 1999). Services can be said to be intangible, even if the degree of immateriality will vary. This means that customers are not aware exactly what they are buying, and services can therefore be considered achievements. A service is also created and utilized at the same time, but the degree of overlap may vary. The third characteristic is heterogeneity, which increases if it is people who provide the service. The last characteristic is transience; the service cannot be saved if not used. This will also apply to varying degrees for distinct types of services (De Jong et al., 2003). Products and services can therefore be considered as two extremes on a scale (De Jong et al., 2003). Easingwood (1986) argues that products and services cannot be separated as easily as described, as not all services contain all the characteristics. For example, technology can have an impact on a service offering, so that the delivery of the service becomes homogeneous or that the service is not produced and consumed at the same time. Vargo & Lusch (2008) have also argued that products and services cannot be separated

as described above. They take starting point in service-dominant logic, based on the principle that services are the fundamental basis for financial transactions.

As markets are becoming more dynamic day-by-day, firms need to innovate their processes and services, in response to changing customer demands, to utilize and take advantage of opportunities in latest technology and market change (Baregheh et al., 2009). In today's global competitive market, changes are so rapid and instant, and the innovation capacities provide the firms with the advantage of enhancing their performance and gaining competitive advantage. Innovation can be described as a multi-step process to which companies transform ideas for new or upgrade products, services, or processes to excel, differentiate or compete in the market (Baregheh et al., 2009). Today, the pressure of outer circle and environment has pushed the companies to make innovation. Organizations contribute in innovations to succeed, use efficiently the scarce resources, meet customer demands, enhance service quality, obtain different skills, and reach their goals (Damanpour et al., 2009).

Most firms need to innovate to varying degrees to be successful longer time (O'Reilly & Tushman, 2004). They must continuously perform incremental innovation, minor changes based on existing technology, knowledge, or activities. These changes are often developed to meet the needs of existing customers (Iden et al., 2013). Companies must also implement architectural innovation, i.e., apply technology or process enhancements to modify a component in business. Firms also carry out discontinuous or radical innovation, i.e., a step-by-step development that changes the competitive basis in the industry as can make old services, or ways of working, outdated (O'Reilly & Tushman, 2004). The degree of innovation can be presented as an innovation continuum, from incremental via architectural to discontinuous innovation. Incremental innovation is new to the company while radical innovation is new to the market (O'Reilly & Tushman, 2004). Service provider businesses engage in services innovation for retaining their competitive advantage or improving their competitive standing in the competitive world. Service innovation indicates new, changed, or improved service concepts or delivery processes which provide innovative or improved way-outs to the client's problem and/or needs with added value (Tidd & Hull, 2003).

Various researchers have attempted to describe service innovation. For example, Hertog (2000) has issued the "four-dimensional model of service innovation", which describe the idea and term service innovation in a knowledge-based market. This model is comprised of

the following four dimensions (pp. 494–498): (1) Service concept; this is a new service in the market, (2) Client interface; this refers to new methods to which customers are engaged in the service creation and production, (3) Service delivery system; this includes new ways the services are provided to the customers, (4) Technology; which should ensure that the services are delivered efficiently.

The global shift in the economy from being product-oriented to service-oriented changed the focus within the service innovation literature (Chae, 2012). Especially during the 1990s the service innovation field gradually expanded because of significant changes in the perception of services and innovation in these services. Services were recognized as a significant part of innovation processes, so that service providers were no longer portrayed as passive recipients of others' innovation. Furthermore, attention began to revolve around non-technological elements in innovation processes to grow (Gadrey & Gallouj, 2002). Moreover, researchers as well as policy makers have also become increasingly interested in service innovation, because service innovation has grown up in many industrial economies and is being expected to contribute a positive effect in the overall economy (Tipu, 2011; Miles, 2005). In service economy there was a lot of focus on information and communication technology (Gallouj & Savona, 2009; Barrett, et al., 2015).

Moreover, technology has led to radical shifts in service innovation and helps to replace the traditional services, in addition to enabling new types of services (Helkkula et al., 2018; Fitzsimmons & Fitzsimmons, 2006). In recent years, some of the greatest opportunities in service innovation have come because of growth in digital technology, social media, and digital markets (Ardley & MacManus, 2019). More researchers believe that this technology approach has limited the concept of innovation only to the introduction of modern technology (Hertog, 2000; Gallouj & Savona, 2009). In recent times, research has found other resources beyond technology, which are important for service innovation. Especially knowledge resources can be crucial for economic success and innovation (Singh et al., 2020). Furthermore, the focus on service-dominant logic has been a driving force for current research in service innovation, as previous logic has been criticized for being product dominant (Barrett et al., 2015).

Damanpour et al. (2009) has also described that innovation is considered one of the main sources of economic growth in companies. Cefis & Masili (2006) concludes that small firms without any innovation strategy have more chances to exit the market whereas small firms those utilize the most benefits of innovation have more chances to survive in long term.

Service innovation is a key driver of economic performance in the survival (Singh et al., 2020; Storey et al. 2015; Tajeddini et al., 2020). According to Manjon et al. (2016), decision to make innovation in services is due to the customers' need which is a trigger point for research and development for innovation in small enterprises. Singh et al. (2020) explains various internal factors facilitating service innovation in the firms. They highlight many organizational and individual factors from systematic review of service innovation implementation.

It has been reported by CPA Trendlines.¹, that clients' demand for a deep and profound understanding of their business from audit firms is the most required attribute. Most firms develop their service design to fulfill customers' needs. These firms provide existing clients with modified services such as tax planning, valuation, and legal expertise (Yeh & Sur, 2015).

Miles (2008) state that knowledge-intensive firms, whose professionals often generate solutions for clients those are ad hoc and highly customized. Their innovations typically rely on employees' professional skills. For small and medium-sized firms to succeed, the main approach is to get rid of the thinking that only big firms can carry out innovative activities (Mompo & Redoli, 2009). A common understanding of what service innovation involves and how it is to be studied has not yet emerged. This may be due to the complexity of service innovation because of variation in corporate innovation behavior in different industries. Furthermore, the basic logic behind it is constantly evolving research, which makes service innovation an attractive research topic (Carlborg et al., 2014; Tynnhammar, 2020).

2.1.3 Service Innovation Processes

Froehle & Roth (2007) present a framework for service innovation and believe that by a combination of resources and processes, companies differentiate themselves from competitors. Simultaneously this will promote continuous innovation and growth in the company. Processes refer sets of actions that are repeated over time and that allow leaders to perform a certain business assignment (Pentland & Rueter, 1994). We want to further illuminate innovation processes. Some companies arrange innovation processes in defined innovation projects, where an innovation represents a final goal. Others integrate innovation processes in ordinary business operations and works with continuous improvement of their services and business processes.

¹ CPA Trendiness, new survey results: Tough times reshape client expectations. [Online]. Available: <http://cpatrendlines.com/2011/08/10/new-survey-results-tough-timesreshape-client-expectations>

Ad hoc innovation is when expertise and elements are developed in a tailor-made situation and can be transferred to new situations, even if the customer-specific solution cannot be transferred (Gallouj & Weinstein, 1997). The possibilities for ad hoc innovation may increase in line with the bigger size of the service-oriented company and the customer (Sundbo & Gallouj, 2000). Stage-gate and agile are innovation processes that can also be used. Stage-gate consists of several phases (stages), where a project team can find the necessary information and makes subsequent data integration and analysis. This is followed by evaluation where it is decided whether one will continue to invest in the project (Cooper, 2008). This is a disciplined approach to innovation, where you divide the process into different phases, from idea to launch. The evaluations act as quality control, where resources are committed to the next phase and weak projects phased out. This process therefore enables an incremental investment approach such as to minimize risk (Cooper & Sommer, 2016). In contrast to this is the agile innovation process, where the focus is on agility, adaptability, and speed of development. In practice the innovation process consists of a series of short sprints conducted by a dedicated project team, working on the project full time. Each sprint should end with a solution which works and can be demonstrated to stakeholders (Cooper & Sommer, 2016).

Tajeddini et al., (2020) explains that no consensus has been made regarding service innovation process. Ambiguity is due to experiential service offerings, lack of applicability of measuring methods and problems in the transferability of models into heterogeneous group of service sectors.

2.1.4 Professional Service Innovation Process

Sundbo & Gallouj (2000) argue that professional service firms have specific innovation processes, due to the firms' distinctive features. They describe two typical innovation patterns for professional service companies: professional service process and organized strategic innovation process. In both the patterns the professional employees are considered as “business contractors” who participate in a collective innovation process (Fischer, 2011).

The professional service innovation process is a collective process and all the professionals are expected to take part in this innovation process. Sometimes It would be a more disciplined, and less radical. Certain professional methods and norms are often followed by the professionals in their innovation. Professional service innovation process is less rigid, able to respond quickly to market conditions, able to cross ideas synergically of its members.

In service professional process, individual competencies and expertise is the main lever or driving force of innovation which suits to the service-professional trajectory. Interaction with

the customers is an important locus of innovation. Thus, the client plays a much active role. The ad hoc mode of innovation plays a vital role here (Sundbo & Gallouj, 2000). Bruns (2011) and Shaughnessy (2010) have employed the term “ad hoc innovation” to designate the kinds of innovative practices that arise from specific economic or technological circumstances rather than as the result of long-term strategic decisions. Figure-1 shows the innovation processes for creation of new services.

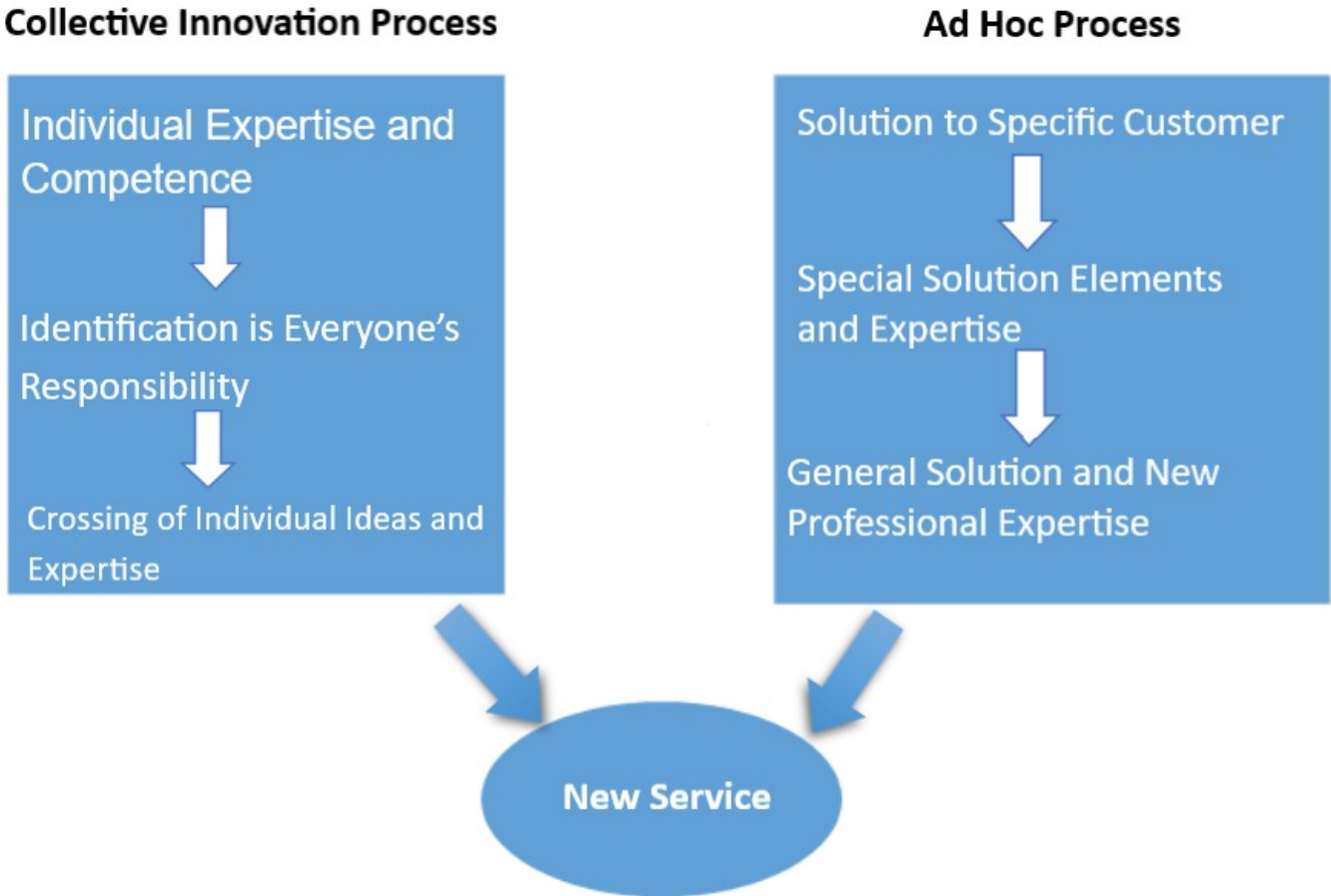


Figure-1 Professional service innovation process (Adapted from Sundbo & Gallouj, 2000).

2.1.5 Organized Strategic Innovation Process

Organized strategic innovation process described by Sundbo and Gallouj (2000), has an overall policy or strategy for innovation, but there is no permanent department for innovation. This innovation process enables management to better manage the innovation process so that the company is likely to perform better (Sundbo & Gallouj, 2000). In this pattern, innovative ideas are also everyone's task, but the time-consuming development is made by project groups. The innovation policy is supported with two measures: knowledge sharing of individuals within the company and quality control to check the service standard. The

innovation process results in a balanced entrepreneurship where the employees behave as corporate entrepreneurs, whereas management tries to control and regulate the firm's innovation processes. The framework for quality control is mostly the innovation policy in the firm. This policy in this pattern should be slightly predefined so that the company looks for many areas to be able to innovate (Sundbo & Gallouj, 2000).

Professional service firms offer services based on the client's uniqueness. If innovation had been integrated as part of a fixed process, firms would have been dependent on an innovation process for services like the innovation process for products (Ross, 2016). Nevertheless, we see from the various innovation processes that there are certain phases a service innovation always wants to go through in audit firms. Since the auditing companies are professional service companies so innovation will be everyone's responsibility. In accordance with the innovation process stage-gate, service innovation goes through various steps in the development.

As Ross (2016) argues, this part of the process will not be fixed. In an ad hoc process, the development will vary, as clients' needs can be different. We call this part of the innovation process the development phase. In a stage-gate process, each evaluation acts as quality control, which is an important part also in organized strategic innovation process. The last part of the innovation process is therefore called quality control and launch. Figure-2 shows the organized strategic innovation process.

Organized Strategic Innovation Process



Figure-2 Organized innovation process (Adapted from, Sundbo & Gallouj, 2000).

There is not any significant evidence found in the literature that shows how these innovation processes being developed and applied in SMPs. Most of the literature is relevant to large audit firms, so we would like to study these, further, with respect to SMPs in Pakistan.

2.1.6 Social Capital Theory of Innovation

Knowledge resources, such as experience, customer feedback, competitor actions etc., provide information regarding innovations in service processes. An interaction of the firm's social relations and network resources, with the inclusion of expansion of the network itself, makes social capital (Gulati, 1999). Social capital theory of innovation recommends that the relationships and interaction between actors add value and creativity by increasing the efficiency and speed of information transfer and new knowledge development which results in innovation (Lee et al., 2001; Sherif et al., 2006).

Trust is developed with the time in which repeated series of interactions occur. Firms in social environment characterized by elevated levels of trust have more chances to innovate. Social capital can be in different forms, primarily trust, networks, and norms (Fountain 1998; Lesser 2000; Putnam 1993). A link is made by Rutten and Boekema (2007) and Shan et al. (1994) who support the view that collaboration

and cooperation are necessary to the innovation process. Moreover, they consider social capital to contribute very important part in the effectiveness and efficiency of collaboration and cooperation.

Trust is considered by Fountain (1998) as a prerequisite for effective innovation collaboration. A fundamental connection between innovation capabilities and social capital emerges from a strong comment mention by Putnam (1993; p.171) that ‘trust lubricates cooperation’.

Social capital is a main source for competitive advantage and sustainability, and play very crucial role in the success and growth of service providing firm. Social capital results in better outcomes if appropriately managed. Particularly, investment in employee social capital creates successful access knowledge, information and resources that are prevailing in the knowledge based networks of firm (Maurer & Ebers, 2006).

2.2 Factors Facilitate Service Innovation

Based on the review of the literature, following factors are identified as facilitators of service innovation in auditing SMPs.

2.2.1 Human Capital

Becker (1962) recognized human capital as the most principal component of intellectual capital in an organization. Human capital is the only intangible asset which can be acquired within the company and can consequently be called a generative intangible asset (Ahonen, 2000). Ahonen (2000) describes generative immateriality as that of the company knowledge capacity by the individuals’ competence, interaction capacities, external networks and learning and innovation skills. Integration of knowledge will be able to provide long-term competitive advantage, as tacit knowledge is difficult to copy (Alvesson, 2004; Starbuck, 1992). Knowledge thus constitutes a key dimension for the firm and is consequently the intellectual resource. The concept of knowledge is broad and abstract and has been part of the epistemological teaching ever since the classical Greek era (Alvai & Leidner, 1999). Alvai & Leidner (1999) have defined knowledge as a grounded personal belief, which increases an individual's capacity to exercise effectively actions or measures.

Howells (2002) believes that knowledge is crucial for innovation. To be able to innovate, firms are depending on being able to utilize existing knowledge, in addition to generating and acquiring new knowledge. Innovation is thus largely about sharing knowledge, which makes learning as crucial point (Howells, 2002). The term knowledge management refers to the management of knowledge, various organizational processes, and practices to achieve value from the knowledge (Zhang & Dang, 2019). This is about having an environment and system to capture, organize and spread knowledge in a company. This can be done by

systematization strategy or personalization strategy. A systematization strategy explicitly strengthens knowledge and improves dissemination and sharing of such knowledge with the usage of information systems. A personalization strategy is about sharing expertise in a firm, for example collaboration or communication (Chen et al., 2012). In other words, knowledge management is a continuous interplay between tacit and explicit knowledge to transfer individual to organizational knowledge, as tacit knowledge is considered the most valuable (Halawi et al., 2005; Larsen, 1998).

As providers of knowledge-intensive services, knowledge is considered one of the core resources in professional service firms. Knowledge management will therefore be important; as well as it becomes important how these can be used to promote innovation (Løwendahl, 2005; Penrose, 2009). For knowledge-intensive companies, service innovation often takes place through new and expanded knowledge. This is challenging because the knowledge lies with the employees in the form of silence knowledge (Fosstenlökken et al., 2003). Werr (2012) points out that both formal structures and informal aspects are necessary for the sharing of knowledge, in a way that allows the company to use accumulated knowledge for service innovation.

Starbuck (1992) believes clients often want firms where employees have expertise and knowledge of social and technological change. It may be said that professional service companies tend to strategically innovate and develop their employees' knowledge to maintain the demand for their employees (Starbuck, 1992). Furthermore, Pfeffer (1994) believes that the distinctive competence of professional firms lies in the skills of the employees. He believes that if employees do not feel a sense of belonging to their firms, the firm's competitive position will be weakened, because the employee can easily change firms. This means that the companies should have a strong focus on recruitment and selection of new employees, and to build strong cultures to retain employees, as these form the basis for the company's success (Pfeffer, 1994).

The study by Sorescu et al., (2007) further shows that the biggest difference in innovation context is due to the various companies' ability to recruit and retain employees with a higher degree of technical understanding. Several studies, for example, by DeAngelo (1981), Porter (1993) and Sutton (1993) show that the auditor's knowledge is important for the quality of auditing. If employees leave the company, this will reduce knowledge, which in turn reduces the audit quality and the general level of knowledge in the company (Chi et al., 2013; Öhman et al., 2012). A high turnover will affect the ability to innovate, as companies are dependent on transforming knowledge to learn and innovate (Chen et al. 2012) so

especially SMPs may suffer more in case of resignation by key and competent staff which also may affect innovation practices negatively.

Littlewood (2004) highlights the importance of Human Capital, and it is one of the key factors that determine and ensure firm's competitiveness. Carson et al., (2004) explains that human capital comprises tacit knowledge, communication and interpersonal skills, entrepreneur spirit, and other personal attributes of firm employees such as aptitude and attitude for long-term learning. Sundbo et al. (2015) explains the employee's ability to understand and translate clients' needs, requirements, and situation. They conclude that employees' translation and multitasking abilities helps to create new services while performing their routine works.

In recent times, research has found other resources beyond technology, which are important for service innovation. Especially knowledge resources can be crucial for economic success and innovation (Singh et al., 2020; Storey et al., 2015; Tajeddini et al., 2020). Damanpour (2009) also states that to manage external dependencies firm's leaders should be motivated to offer new services to maintain their connections with customers. Literature (Andriopoulos & Lewis 2010; Beckman, 2006; Lavie & Rosenkopf, 2006) also support firms' practices that degree of innovation is affected by how a project team is put together. Sundbo et al. (2015) emphasises on service encounters as bases for innovation and they use the terminology "Co-innovation" for innovation during encounters between employees and clients in services.

2.2.2 Digitalization and Technology

Technology has led to radical shifts in service innovation and helped replace traditional services, in addition to enabling new types of services (Helkkula et al., 2018; Fitzsimmons & Fitzsimmons, 2006). During 1960s technological development has resulted in larger and more complex business ventures (Teck-Heang & Ali, 2008). It is argued that the long-term growth of an advanced economy is dominated by developments in technological progress (Brynjolfsson & McAfee, 2014). Technology has led to exponential growth in both financial and non-financial data (Hindberg, 2015). In recent times, the term Big Data has been widely discussed and these are large data sets in high speed, consisting of structured and unstructured data, from internal and external sources (Dey et al., 2018).

Analysis tools are used to generate, store, and analyze enormous amounts of complex and variable data. This is used to achieve knowledge that can be transferred to better business strategies (Hindberg, 2015; McAfee & Brynjolfsson, 2012) and innovation. A technological tool was used in the development of Bitcoin is blockchain technology. Gökten, et al., (2019)

believe that this technology is one of the most important developments in technology since the internet, due to the potential for exploitation in other sectors. Blockchain eliminates transactions and contracts used in regulated remittances, and thus reduce the transaction costs of online payment. Technology security also allows buyer and seller meet without intermediaries (Gökten et al., 2019). Nwankpa & Roumanis (2016) explain that it is important that firms keep up with digital innovations and the opportunities it brings. A much talk about technological concept is Artificial Intelligence (AI).

Artificial intelligence can be promoted by implementing Robotic Process Automation (RPA). A robot can automate predefined processes by capturing and interpreting existing applications. Repetitive and manual tasks can thus be automated (Lhuer, 2016; Gami et al., 2019). An obvious advantage of RPA is that robots do not need breaks or holidays and are cheap labour. Enterprise Resource Planning (ERP) systems also play a vital role in the success of modern companies (Antonovia & Georgiev, 2019). Implementation of technological tools is at an early stage in the firms and still is under development. Integration and implementation of technology creates future opportunities for new services in the auditing companies (Brown-Liburd & Vasarhelyi, 2015; Denning & Lewis, 2016). An alternative to traditional audit was presented by Vasarhelyi & Halper (1991), called continuous audit. Continuous auditing gives the auditor the opportunity to deliver a new type of auditing service, where the focus shifts to auditing system and operating results in real time (Rezaee et al., 2002).

It is therefore expected that auditor stays up to date on the technological development and is at the same technical level as their customers want so not to weaken audit quality (Alles, 2015; Ghasemi et al., 2011). According to Alles (2015), auditing firms will try to adapt to customer practices, and are often reluctant to use technology that is far ahead of those adopted by their clients. According to Piccinini et al. (2015), technology has changed customer behavior, and interaction between consumers and producers. The study shows that customers to a greater extent use digital tools to compare products and prices and do business on their own terms. This change in interaction between consumer and producer creates greater need for faster information about products and / or services (Piccinini et al., 2015).

Kang et al. (2015) and Peecher et al. (2013) argue for that legislation encourages auditors to perform defensive audits. They believe that accountant focuses on traditional procedures because these are generally accepted. This counteracts introduction of innovative solutions. Regulatory changes have therefore been proposed to open to innovation by

auditors, without new methods being met with skepticism (Peecher et al., 2013; Kang et al., 2015).

Ahmi and Kent (2013) conducted the research on SMPs in UK to understand the utilization of audit software by the external auditors. They conclude that less evidence is witnessed that computer assisted audit tools and techniques (CAATTs) has been adopted by external auditors in SMPs in the developed country. This is also evident from the literature that auditors need training to use audit software (Singleton, 2006). Technical problems in handling clients' data are already highlighted in the literature such as, often auditors may face problems in making the data for initial usage (Braun and Davis, 2003) which means transferring the appropriate and required data from client's system into auditor's system (Ahmi and Kent, 2013). Research by Waldon (2018) also states that auditors handling small clients encounter problems in transferring data to various audit tools. This supports the literature as Damanpour (2009) explains that innovation facilitates necessary adaptive changes to the environment and innovations in service firms primarily do not follow and go after technological imperative. In recent years, some of the greatest opportunities in service innovation have come because of growth in digital technology, social media, and digital markets (Ardley & MacManus, 2019).

2.2.3 Customer's Demands

Service innovation derives when a firm can center its all energies to think on the behalf of the customer (Kandampully, 2002). As CPA Trendlines² reported that there is an increasing demand from clients to their CPA firms for a more profound and deeper understanding of their own business. Demand is necessary for innovative ideas' successful exploitation. Without consumer uptake innovations cannot be viable (NEST A, 2010). The firm's behavior is drive by the demand of customers and service firms compete by realizing the need of development of new services for satisfaction of customer demands in a responsive and timely manner (Alam, 2002; Kelly & Storey, 2000; Lovelock, et al., 2001). Inspiration for innovation comes from a specific part of the market or need of the society (Godin, 2006). To become successful and drive the marketplace, firms should anticipate and develop value added and innovative services while listening to customers' demands (Kandampully, 2002; Magnusson et al., 2003).

² CPA Trendiness, new survey results: Tough times reshape client expectations. [Online]. Available: <http://cpatrendlines.com/2011/08/10/new-survey-results-tough-timesreshape-client-expectations>

The customer contact's importance is noted in the literature, that it enables to understand the customer demand and its implications on design of service innovation (Lievens & Moenaert, 2000; Ostrom et al., 2010; Spohrer & Maglio, 2008). Consistent with past research, Berry et al. (2006) argue that a comprehensive customer experience can be delivered with the firm's understanding of customer demands in all markets and it is suitable for creating service innovation.

The IAASB (2016) claims that clients who use advanced technology to operate their companies and record their financial transactions, may have expectations of the auditor also utilizes technology efficiently. Customers demand much involvement, personalization, customization, and mobility with immediate outcomes. When customers receive more service innovations within one industry, they anticipate having such innovations in other industries as well. Industry boundaries are becoming blur for consumers, organizations should find novel ideas to compete the rivals (D'Emidio et al., 2015). Organizations have tried to understand their customers better for customized and personalized products to fulfill their needs. This wisdom still prevails, spread of mobiles and advent of new datasets indicate that services can be customized cost effectively up to much extent (D'Emidio et al., 2015). When customer expectations or tastes fluctuate, or competitors present new products or service, organizations will face more pressure to innovate, and the level of innovation may be anticipated more. This is true for both conservative and entrepreneurial firms (Miller and Friesen, 1982). The preferences and needs of the consumer can influence a product or service innovation at any stage of a product's development (NESTA, 2010).

2.2.4 Regulatory Compliance

Sadiq and Governatori (2015) define the compliance as ensuring business operations, processes, and practices in accordance with prescribed or agreed standards and norms. Compliance requirements may be from regulatory bodies, legislature, standards, and best practices. On the other hand, market value of compliance related services and software was estimated over USD 32 billion in the year 2008 (Hagerty et al., 2008). This much rise in the business investment is mainly due to consequences of regulatory compliance and mandates that emerged after events of largest scandals in the corporate sector such as Enron, WorldCom, Societe Generale (France) and HIH (Australia). Despite clear deadlines, still many organizations are struggling with compliance (Sadiq and Governatori, 2015) which make the companies to take help from business consultants and audit firms.

Jiang et al., (2015) state that every organization, whether public or private, should ensure that its business operations and processes are complied with regulations of government and other affiliated bodies, otherwise its business may attract lawsuits, penalties, and financial losses and even business may be disallowed to operate due to adverse non-compliance of requirements and regulations. Therefore, companies should have clear knowledge and understanding of all the concerned and relevant regulations and ensure their compliance in all the business activities and processes. Further, when considering many regulations together, checking of compliance becomes more complex due to their interrelationships (Jiang et al., 2015). Compliance was previously considered as a burden; however, companies have started to take the regulations as a good opportunity to improve and strengthen their business operations and processes (Sadiq and Governatori, 2015).

2.2.5 Auditor-Client Relationship and Trust in Relationship

According to Granovetter (2005), social conditions influence the company's actions through the way they manage the company's information access and expose them to different types of information. The social relationship will thus be of great importance in auditing, as information asymmetry typically exists in the auditor-client relationship. The audit client, including management and other employees, will usually have greater company-specific knowledge than the auditor. Explanations from management and employees are also often useful starting points when the auditor is to gather evidence to verify statements in the accounts (Kopp et al., 2003).

Unlike service delivery in traditional supplier-customer relationships, audit clients can thus be understood to be co-producers of the audit product (Fontaine & Pilote, 2012). This can lead to that stronger psychological bond are formed between auditor and client (Suseno & Pinnington, 2018). Rousseau (1995) explains psychological contracts as individual assumptions which are shaped by the firm with the terms of exchange agreement between individuals and their companies.

Relationship between the auditor and the client is said to consist of both a professional and personal relationship (Richard, 2006). According to Richard (2006) the professional and business relationship should be supplemented with a personal relationship, and then the auditor's work is based on trust between auditor and client. Liljander & Strandvik (1995) state that the psychological bond reflects customers' values, norms, and preferences, and is developed when the customer is assured that one service provider is better to others. In an indifferent relationship, therefore, the customer will not feel some real difference between

service providers (Liljander & Strandvik, 1995). In the auditor-client relations, it is the customer who normally wants the balance of power, and that is why the customer's view in the relationship is considered much important (Kuenzel & Krolikowska, 2008).

Other researchers have also emphasized the importance of the social relations in professional services. Business describes success, among other things, is being dependent on how well the individual manages to build social networks and retain loyal customers (Gronroos, 1979; Mouzas & Naude, 2007). Loyal customers are desirable because it can bring a number of financial benefits such as increased sales, higher entry barriers for competitors, as well as make customers less receptive to offers from competitors such as offering lower audit fees (Delgado-Ballester & Munuera-Alema'n, 2001). Previous research also suggests that loyal customers are less price touchy (Reichheld & Sasser, 1990) and trustworthy relationship can compensate for higher audit fees (Fontaine et al., 2013). Loyal customers will also be more likely to recommend the audit firm further. In the literature, these personal recommendations are referred to as "Word-of-mouth" references and according to Kirchmajer & Patterson (2004) it is particularly much importance for small and medium-sized businesses when it comes to attracting new customers.

According to Broschak (2015), long-term relationships reduce information asymmetry and uncertainty because of the trust between auditor and customer being strengthened. On the other side, long-term relationships between auditor and customer can also be more prone to change auditors. Levinthal & Fichman (1988) explain that clients' resources and competence requirements can change over time so the connection / link between auditor and client may be reduced. Herda & Lavelle (2013) find, for example, in their research study that audit clients value continuity in the service offer. This means that large replacements in the audit team are not desirable from year to year. This is especially important as the study points out that the more time an auditor spends with a client, the more committed the auditor becomes to the client. According to the authors, this has the sense of commitment matters to the extent to which the auditor offers services that are not direct related to the preparation of the audit report (Herda & Lavelle, 2013). Clients both want, and in many cases expect the auditor to provide services beyond the core audit (Fontaine & Pilote, 2012; Fontaine et al., 2013), and research suggests that much of the audit value comes precisely from additional services such as consultancy (Beattie et al., 2000; Eilifsen et al., 2001). Herda & Lavelle (2013) also believe that auditing companies should promote continuity in the audit teams with a view to strengthening the level of cooperation between the team and the client.

An important finding is that the core product, the audit report, is basically considered a homogeneous product and that what separates the auditing firms from each other is the relationship between customer and auditor. Another interesting finding in the study is that price only become important when the customer relationship is poorly managed, such as when clients experience that the auditor is not available to them (Fontaine et al., 2013). Sarapaivanich & Patterson (2015) discovered like Fontaine et al. (2013) that perceived value does not appear to be affected by clients' views on the technical quality of the audit report. The strongest value driver, on the other hand, is the quality of the interpersonal contact. Goldman & Barlev (1974) believe that the client has the most power in the accountant-client relationship and explains this by saying that auditors are in a relatively weak position when disagreements arise with its customers.

According to several researchers, auditing firms therefore try to differentiate themselves through customer service, more specifically through increased process quality and reporting, and effective communication with both existing and potential customers. However, relationship marketing can be complicated in the auditing industry. On one hand, the auditor must be independent and show integrity, while on the other hand, higher competition and more demanding clients will force the auditor to sell other services that are not directly related to auditing (Kirchmajer & Patterson, 2004) which may impair independence and audit quality (Kang et al., 2019, Causholli et al., 2015). Business describes success, among other things, is being dependent on how well the individual manages to build social networks and retain loyal customers (Gronroos, 1979; Mouzas & Naude, 2007). Vossen & van Gestel (2019) uses the translation studies in the adoption of innovative ideas through social interactions and highlights the crucial role of interpersonal relationships for outcomes.

2.2.6. Research Model

The below research model tries to summarize how the theoretical framework is built up to answer the research questions of the thesis. This is structured through a discussion of relevant theory related to the research questions, as illustrated below in Figure-3.

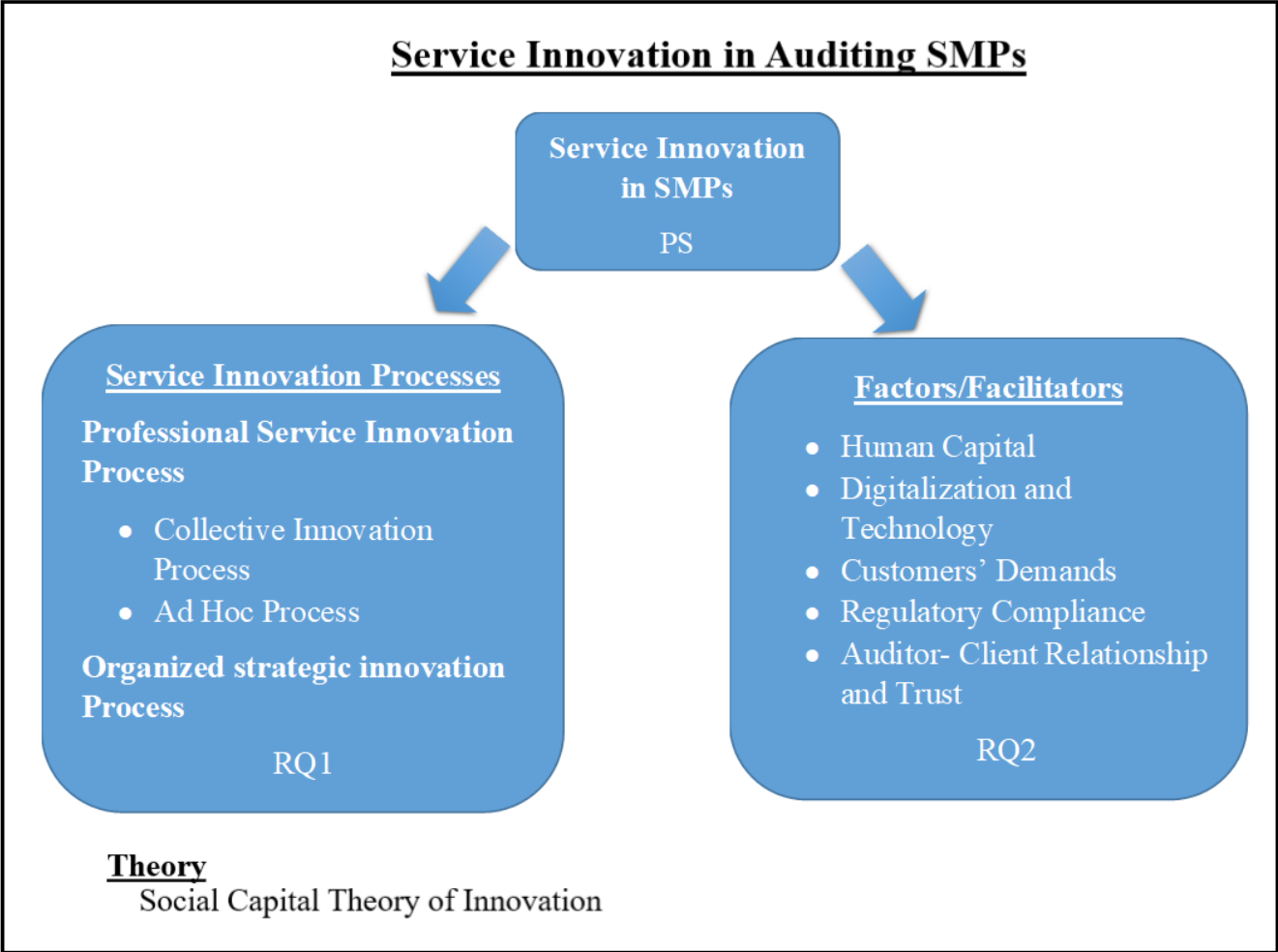


Figure-3 Research model developed by authors.

To address the research problem, we started with the literature review of auditing and service innovation and especially in small firms. Later, we studied several types of service innovation processes to get the insight knowledge about our first research question. At the end, literature about several factors facilitating service innovation in the firms was studied to understand these factors and their role in service innovation for second research question. We want to get insights about our research questions based on social capital theory for innovation.

3.0 Research Methodology

In this chapter, we will shed light on how we have proceeded to acquire the empirical data. Method can be understood as a recipe for how the researcher has conducted a research, and includes, among other things, the procedure for collection, analysis, and interpretation of data (Johannessen et al., 2011). Explanation of method is important because it makes it possible to assess whether the research findings are due to the method (the research effect), or whether the results reflect the social “reality” (Jacobsen, 2005). According to Hellevik (2002), methodology also makes it possible for researchers to take lessons learned from previous studies and any advice given in connection with further research. On this way, the researcher is pointed in the right direction, and can prevent that person is tempted to let the desired results guide the research (Hellevik, 2002).

3.1 Research Design

The research design describes how a research scheme should be designed, or how the researcher must proceed to answer the problem (Johannessen et al., 2011). The problem deals with service innovation in auditing small and medium practices, and it is necessary to go more in depth in the field of research. That is why our master's thesis is natural to choose an exploratory design, where the purpose is to explore the topic in detail. According to Jacobsen (2005), the research problem will govern research design. In our case, we want to take a closer look at a specific topic within a specific industry. According to Jacobsen (2005), intensive design allows the researcher to go in depth, and thus obtain detailed descriptions of the phenomenon as studied. A weakness with intensive research programs is that the study often becomes specific, which makes it more difficult to generalize the findings (Jacobsen, 2005). The purpose of our task, however, is not statistical generalization, but to gain a deeper insight and understanding of the phenomenon of service innovation in the audit context. We have therefore chosen to organize the semi-structured interviews with informants from auditing small medium practices (SMPs) from Pakistan.

3.2 Research Method

Within the social science methodology, a distinction is made between quantitative and qualitative method. The difference is based on how the data is collected and analyzed. In general, qualitative methods are chosen when the research involves the processing of text, and quantitative methods when it involves processing numbers (Johannessen et al., 2011). According to Jacobsen (2005), the problem will also govern the choice of research

method and distinguishes in this context between two types of issues, exploratory and testing issues. Exploratory research is based on an explanatory problem and is chosen when the researcher wants to gain a more holistic understanding of a phenomenon.

This often results in choosing to focus on a few units, so that you can study more nuances of the phenomenon. In situations with exploratory issues, it is the qualitative approach that itself is best. The purpose of this research is to get a deeper understanding about how small and medium-sized audit firms are related to service innovation. The qualitative and the exploratory research method thus appear to be the most appropriate to get answers to our problem.

3.3 Data Collection

According to Johannessen et al. (2011) data cannot be considered as reality itself but is something the researcher creates or produces through his experiences and observations. Data reflects therefore only parts of reality (Johannessen et al., 2011). A distinction is typically made between primary and secondary data. Primary data or empirical data is used about the information collected using of social science methods (Johannessen et al., 2011), while secondary data are data such as already exists and is consequently not constructed for the researcher's purpose (Gripsrud et al., 2010).

Our theoretical framework is mainly based on research articles found via search engines like Google Scholar, Scopus, and Research gate. We have also used previous dissertation literature. According to Jacobsen (2005), credible sources are particularly important in research, and imply that the researcher critically assesses which sources are included in the research. We want full and detailed descriptions of the phenomenon service innovation in the SMPs, so we decided to conduct semi-structured interviews to get in-depth information on the topic.

3.4 Interview Guide

The interview guide is designed based on the problem and associated research questions and contains more general questions about the service innovation, and more specific questions on how audit firms are developing service innovation and what are the key factors that facilitate service innovation in SMPs. The interview guide was sent in advance to each interviewee so that each informant had the opportunity to form some thoughts on the topics we wanted to go into more detail. We chose to use semi-structured interviews, as we

believe the flexibility built into this type of interview provides a more natural flow in the conversation.

3.5 Selection of Informants

The data collection has consequently been concentrated around the management in SMPs, and it corresponds to what Johannessen et al. (2011) describes as strategic selection. The focus on management has been chosen because previous literature claims that service innovation is a collective process for professional service companies, and it involves everyone including management and employees. At the same time, there is reason to believe that managers in small firms have broad areas of responsibility, and thus are knowledgeable about the entire business.

We observed convenience sampling as references and networking helped us to approach the key informants in the audit industry in Pakistan. We started to contact concerned persons in audit firms who were suitable for interviews about the topic. Since one of the authors has previous audit related experience, his contacts with the friends and colleagues have helped us to approach to different persons in small and medium audit firms. Twelve persons having relevant experience and knowledge about service innovation in SMPs were shortlisted and they agreed to the interviews providing we will ensure strict confidentiality. In the end we could manage to take interviews with ten (10) informants who were fit to our selection criteria.

We started the informants' selection process, initially, by approaching the SMP's committee of ICAP through email and requested them for semi-structured interviews with some partners / managers / key persons involved in service innovation in small and medium audit firms in Pakistan. Two soft reminder emails were sent, but no reply was received. We hoped to also get an interview with one of the top persons in the SMPs committee, but he excused himself claiming that the requested information is confidential in nature. Hence, they did not disclose information about the services. In the second stage, we took details of all SMPs from ICAP website and emailed all these SMPs with the requests for interviews for this research purpose. Most of the emails were returned undelivered due to incorrect email addresses or old / full email inbox. This strategy resulted in no additional respondents. In the end, we approached the informants through referencing and networking, for interviews.

One of the main criteria for selection of audit firm was to have more than five employees in the firm so we skipped two interviewees due to very small audit firms. During selection, we

also consider including both types of QCR and non-QCR audit firms. We tried to find some informants with audit experience in both big 4s audit firms and SMPs. Both authors of this thesis have their homes in Lahore, which is the second largest city in the country so most of the SMPs with their head office in Lahore were focused for interviews. The list showing details about the informants and their audit firms is attached in Appendix-1.

We have chosen to anonymize all personal and company information and refer to the informants with letters from A to J in the thesis. Regarding the size of the sample, Johannesen et al. (2011) described that it can be difficult to know in advance what the optimal sample size will be. An ordinary approach is therefore to conduct interviews until the informants do not add new information (Seidman, 1998; Kvale & Brinkman, 2009), we also observed that most of the informants shared almost the same kind of information.

3.6 Conducting the Interviews

All the interviews were conducted by WhatsApp and / or telephone call. This is based on practical reasons, such as large geographical distances between the researcher and those who we wanted to interview. In addition, the research study was conducted in the same period as the annual accounts are to be audited which is a very hectic period in the auditing industry. According to Easterby-Smith et al. (2015) telephone interviews can sometimes be preferred among executives, because they can be easier to plan, thus offering greater degree of flexibility.

Interviews are conducted by the male member of the research group because of cultural differences and convenience of interviewees. To document the interview, we used audio recordings with a smartphone. Using an audio file allows for simple documentation of everything that is said verbatim, as well as makes it possible to reproduce direct quotes. According to Jacobsen (2005), direct quotations can give extra weight to a study. A disadvantage with audio recording is that some may react negatively to it, for example by holding back information. However, this was clarified and approved in advance with the informants. The recordings were transcribed after each interview and both authors discussed key points of each interview briefly immediately after interview and/or transcription.

3.7 Principles of research ethics

In this research we consider certain types of considerations. Upon request for participation, each informant was informed that collected data should only be used for the master's thesis and would be deleted after completion of the study. We also emphasized that personal and company data would be anonymized, as the companies are in competitive situation. Before we started the interview, we asked informants in accordance with good research ethics for permission to make audio recordings. We made audio recordings in line with regulations from the Norwegian Center for research data (NSD). Furthermore, the informants were made aware of their participation was voluntary, and that they could withdraw from the interview at any time. The respondents also received offer of the transcribed interview after the interview, and thus had the opportunity to object and ensure the correct interpretation of the data.

3.8 Handling of Data for Analysis

Analysis of qualitative data consists of processing text according to Johannessen et al. (2011). After reading the transcripts several times, the primary data was categorized and structured according to the sub-themes in the interview guide. For initial coding of interviews, we used Excel sheet to systematize and compare the answers and key points, which made it easier to identify any patterns in the responses of the various informants. This data was analyzed and interpreted against the existing theory.

3.9 Quality of the Research

The method section is intended to strengthen the reliability of the thesis by giving the reader a detailed description of the procedure, as this is a prerequisite for understanding our results, methods, and decisions. There are divided opinions about which assessment criteria to be used to assess the quality of research arrangements. We have chosen to follow Johannessen et al. (2010) which uses reliability, credibility, transferability, and verifiability as targets quality.

3.9.1 Reliability

The reliability of the data can be assessed by deciding how and what data has been collected in the research, and how it has become edited (Johannessen et al., 2011). To strengthen the reliability of collected data, we have, as proposed Johannessen et al. (2011), tried to give the

reader thorough and detailed descriptions of the whole research process. Furthermore, we have had a strong focus on the correct use of sources.

The fact that the data collection is based on telephone interviews may impair reliability in the thesis. This is because we as interviewers do not have control over whether the informants were fully present in the interview situation or if they did other things during the interview. By telephone interview we also cannot observe body language and how the individual informant responds to the various questions. If the respondents misunderstand the questions, that fact could weaken the reliability of the data. The same applies if the respondents' answers are misunderstood or not perceived correctly by the interviewer.

To prevent this from happening, we have focused on having relative open-ended questions, and used follow-up questions to ensure that we perceived the informant correctly. During the interview process, we got a better impression of whether all the questions were in fact equally relevant, and whether there were any questions that should have been included in the interview guide. We have therefore in some cases partly gone away from the interview template, which may mean that not everyone the respondents have been asked the same question. This may make it more difficult for other researchers to recreate equivalent results and will therefore reduce reliability.

3.9.2 Credibility

Easterby-Smith et al. (2015) describe validity as to the extent to which measurements and research results give an accurate representation of the things they are meant to describe. The credibility criterion is therefore intended to ensure that the research's findings and results are true. To meet this criterion, we have, among other things, spent a lot of time getting acquainted with the relevant theory, since according to Johannesen et al. (2011) can be difficult to understand a phenomenon if one does not know the context.

3.9.3 Transferability

In qualitative research, transferability is about the extent to which the research project's results are transferable to other similar phenomena (Johannesen et al., 2011). This assumes that the researcher provides thorough descriptions of the situation being studied so that the reader can become familiar with the circumstances and assumptions underlying the researcher's conclusions (Mehmetoglu, 2003). The thesis is organized with a qualitative approach, which indicates that the thesis to a greater extent deals with the transfer of knowledge. Although we find clear similarities in the respondents' statements, we consider

our sample to be too small to be able to generalize our findings to the entire industry. The findings of the thesis would probably be better suited for generalization if we had a larger sample, and / or supplemented with quantitative data. The results are therefore not assumed to be transferable. However, we can point on findings and connections in our thesis that can form the basis for further research.

3.9.4 Verifiability

The criterion of verifiability in qualitative research is about ensuring that the research results are due to the research, and not the researcher's subjective attitudes. It presupposes that the researcher has accounted for all decisions made throughout the research process and informs about factors that may have influenced the interpretation and approach to the project (Johannesen et al., 2011). According to Mehmetoglu (2003), verifiability is also about to be clear on what data one has received from his informants regarding the phenomenon that studied. Throughout the research process, we have tried to give the reader detailed descriptions to increase verifiability.

4.0 Empirical Findings

In this chapter, overview about auditing in Pakistan is explained and then findings from the interviews are presented. The findings have been structured based on the main topics in the interview guide. The respondents will therefore be referred in the form of letters from “A” to “J”. To gain a deeper understanding of the leaders' assessments regarding service innovation, we started each interview by asking the individual to describe service innovation in the auditing industry. Different leaders can have different perceptions about service innovation, and thus attach different meanings to the concept. We will describe our empirical findings as follows.

4.1 Overview of Auditing in Pakistan

Auditing occupation is self-managed in Pakistan. The Institute of Chartered Accountants of Pakistan (ICAP) was formed under the Chartered Accountants Ordinance 1961, and every audit firm must register with the ICAP, so ICAP is considered the governing body of audit firms in Pakistan. The said institute formed QCR (Quality Control Review) program to guarantee the quality of auditing and the audit firms whose clients are the listed companies are restricted to maintain an acceptable QCR rating. The assessment of firms' audit quality by QCR team of ICAP is carried out based on sample techniques, and audit firm with more listed clients has more chances of being selected for review by QCR team. So small audit firms have less likelihood of being selected by QCR team so they may have less pressure to maintain audit quality. Big 4 auditors, as in different South Asian nations, do not work straightforwardly under the name of their brand; rather, they work under the name of domestic associates. According to ICAP³ website there are 631 audit firms registered with the ICAP. These audit firms are categorized in QCR rated firms and non-QCR rated firms by ICAP and ICAP quality control review team perform quality control review of audit firms and issue them satisfactory QCR rating which is valid for only two years. This means that each QCR rated firms must maintain satisfactory QCR after every two years to meet the required standards of ICAP. As of 01 March 2021, ICAP issued as list of satisfactory QCR audit firms through its official website which shows that total 125 audit firms including big 4s could have maintained their satisfactory QCR rating and remaining firms are considered non-

³<https://icap.org.pk/>

QCR audit firms. Non-QCR audit firms have some restrictions like these firms cannot conduct audits of listed companies and they cannot hire CA trainee students etc.

4.2 Service Innovation in Pakistani SMPs

Informant A explains that all other services than accounting and auditing can be categorised in service innovation. He thinks that audit firm's key function is to help clients in book-keeping and conduct external audits to meet the regulator's requirement. Whereas Informant "I" thinks that almost all the audit firms have audit and tax department and these both departments complement each other so services other than audits and tax consultancy can be categorised in service innovation.

Informants E, F and I are of different opinions that audit firms are involved in external audit, tax, and accounts & finance related consultancy since long, so these areas have become core functions of audit firms. However, they define service innovation in audit firms something different which audit firms never experienced before. They explained us some examples of service innovation from their on-going projects. Informant E refers to an example that one of the audit firms has made its engineering department to fulfil the needs of real estate customers and hired some engineers for technical expertise. The same person i.e informant E is now-a-days working on a project to launch a new fresh vegetable stores chain in the country. Informant F is working on a client who wants to produce electric car in Pakistan with the help of a partner from China. Whereas Informant I is assisting a client to acquire a land from Government on easy terms for installation of manufacturing plant of marbles, as previously the client was importing marbles, and this future project will reduce the cost enormously.

Informants were asked about service innovation while performing their core assignments as external auditors.

“When client's business and processes change, the audit firms must adapt accordingly and change their processes or strategies and it may be considered as innovation. Mostly innovations are incremental, with minor changes and improved services in routine services in audit firms.” Informant A

Informant A states that innovation in core audit services and audit methodologies is rare and not frequent. Like, this may happen due to with the changes in regulation and major structural / profile change in the subject (client), so to address this change, they must adopt new audit methodologies and procedures which may involve innovation in their audit procedures. For

example, last year some changes incurred in IFRS reporting standards, so companies must update with new accounting concepts, like some concepts in financial instruments and leasing have been changed. So, trainings and other services to response these regulatory changes, were provided to companies by audit firms to incorporate these changes in their financial statements which became new services for audit firms. But it happens after couple of years when expert feel some indispensable change and update in audit procedures.

“We can only innovate in our audit procedure by using professional and skeptical judgment to ensure better reliance to achieve the final output.” Informant B

Informant B explains that during external audit, they must follow international audit standards, standard procedures and methodologies which may restrict innovation. Often, during external audit, if they are not satisfied with the control implemented by the client in any specific area, they may recommend the client to conduct in-depth separate review for this area which may involve innovative service. If they are sure that this separate review service will not hurt their independence as external auditor, they may accept this assignment, otherwise clients should approach another independent firm or partner without external auditor’s influence. Specifically in audit (external) there is not much innovation involved as they must work under set procedures and methods. Informant D has the same comments that strict standards and methodologies restrict the innovation. He explains further that during external audit, auditor can do some working as per his own convenience whereas result of audit will be as per audit standards. Recently new IFRS standards are introduced by regulators so they implemented IFRS 16 on some new clients and they charge them fee so updates in regulations can also create new services for them to implement in the market, but such services are subject to changes in regulations. Following three points of consideration make the SMPs to consider towards service innovation:

4.2.1 Regulatory Environment

Informant J begins his thoughts about some dynamics of audit industry in Pakistan and shares some facts from the industry that why small audit firms are not focusing on more audit clients and mostly rely on other innovative services to increase their income stream. QCR rated audit firms are only allowed to conduct audit of listed companies in the country and QCR rated audit firms are around 125 out of total audit firms almost 600, only 44 firms out of these 125 QCR rated firms are on the penal of SBP (State Bank of Pakistan) so only these 44 audit firms on the SBP penal have more chances to conduct audits of financial institutions and listed companies. Mostly big audit firms can get the audits of big clients with handsome audit

fees. Rigid circled system is developed by key controlling players in the auditing industry in Pakistan which mostly support big audit firms, only top 10 audit firms in Pakistan can get most of the audits of big companies as per strict requirements and small and medium audit practices firms (SMPs) are less likely to break this system by getting audits of big companies. He further explains that major audit clients (almost 80%) are being taken up by top 10 audit firms of the country and remaining 20% big audit clients which are almost 100 clients are being audited by around 590 SMPs audit firms. Big firms generate good portion of their revenues from the audit fee whereas SMPs could not get more audit clients from the market so to survive economically they have to rely upon other innovative services, and other innovative services to the clients assume to be their lifeline to maintain their existence in the market.

Informant B shares the same thoughts that SMPs have access to limited number of audits as per prevailing system which is more suitable to big firms. Some SMPs rely upon only one to two listed audit clients and most of the SMPs do not have listed clients so they have to provide auditing services to private sector with small clients. Further, there is no requirement for every private limited company to get audited financial statements from auditors, only companies with more than specific amount of share capitals have to conduct annual audit as a requirement, so even most of the good established businesses with enormous turnover do not have any requirement of audit from the regulator. Small clients perceive audits as cost for them because small owner is too much involved in his business that he is aware of its business issues and gap himself. As small clients have not any compulsion from regulator for statutory audits, so they do not move to audit firms. So SMPs conduct audits of only those few audit clients who are mostly reluctant to approach big audit firms.

Informant H expresses another reason why clients do not move towards SMPs for audit. If a company intends to apply for loan or in financing contract with a bank, the same company has to get audited from SBP nominated big firms. Such a rigid system is built by big firms in the country that it is hard for SMPs to penetrate in the market for big and more audit clients.

4.2.2 Economic Pressure

Informant B, C, D and G explain that audit firm is registered, primarily, to provide external audit services to clients whereby they provide independent opinion about clients' financials. They categorise all other services than external audits in other services which may involve service innovation. Aforementioned four informants have the opinion that as external auditors they cannot market their external audit services to attract external audit clients because it is

against the regulations and professionalism in the country. So, they have to create new services other than external audit to increase their income streams through different services which may help them to maintain their economic survival.

“.....actually, external audit is a specific months limited time work, other period of the year we have to utilize our human resources efficiently, so we have to create new services for economic survival.” Respondent D

Informants C, D, F and G explain that SMPs cannot rely upon small and few audit clients, so these firms have to explore other innovative services in the market by using their knowledge and expertise. Informant A describes new services like blood for his audit firm and these other services make them survive in the market.

4.2.3 Customer Orientation

Clients feel pressure for innovative services from audit firms due to two factors, either they feel some internal pressure for services out of their control like fraud, internal control lapses or dispute among partners etc. or regulatory compliance pressures which make them to move towards audit firms.

Five informants (A, B, F, G and J) explain some thoughts about new services where client seeks for unique advises from the audit firm regarding new projects and international affiliation contracts and audit firm may provide feasibility analysis to the clients other than typical accounting and auditing services. So, they provide customised services to the clients to fulfil their specific needs, sometimes they assist their customers through unique services, without having any relevant previous experience in this field.

4.3 Service Innovation Development Process and Facilitators

4.3.1 Idea Generation and Development Process

Informant A explains that new services depend upon what services are feasible according to the firm resources. He explains the idea generation and development process as follows:

“Mostly, ideas for new services arise from staff and customer.....We test the new idea and if do-able, we certainly develop this. In the process, we test like what is required skill-level involved, what is regulatory requirement and implications, risk factors, resources needed, time frame for development and execution etc. then idea is shared among expert partners ad senior employees. If new idea is approved, again risks are assessed by developing different checklists defining different controls and then new services are developed in the end..... Our services are not stagnant; we are improving and adding some services.”

Informants A, B, D, H and J explain that being partnership firms with few partners (not many partners like big firms) as owners of the firm, discussion among partners about ideas of new services and decision regarding implementation and development of new services does not take long path, sometimes verbal consent among partners is enough to introduce new services in the market. New services are created and decided through ad hoc process and some formal procedures are involved but they do not document these decision-making processes, whereas they discuss every service innovation among partners and seniors at initial phases. They scrutinize the important aspects before launch of innovation in services and processes. There is no separate quality control department involved to oversee service innovation development process in SMPs as per our informants, but partners themselves are more vigilant and much involved while creating new services and utilize all available resources because such services can affect their survival in the market. Informant B expresses those services are being created automatically without any much thought, its on-going natural process to create new services or find new clients in the market. In service professional process, individuals' competencies, expertise and skills are the main driving force of innovation which suits to the service-professional trajectory. Interaction of SMPs' employees with the customers is an important locus of innovation. Our findings show that ad hoc mode of innovation mostly plays a significant role in the development of service innovation.

Informant A, B, G and I comment that sometimes they get idea from other audit firms' practices in the market through sharing of ideas among professional friends and through discussion on different forums. Informant A explains that they also get some ideas to include some services from peer firms. Informant A explains that more market research and feasibility is another way of developing new services.

Employees in B and H audit firms have pressure from partners to search the market for creation of new services and study the customer's needs in the market. After discussion with different stakeholders in the market and other peer firms, they explore new services and then they initiate these new services to create new avenues in the market.

Informant B also adds that more partners in their firm focus on short term gains through new and improved services, so idea with short term gains get much attention among partners.

4.3.2 Role of Digitalization and Technology in Service Innovation

The auditor's most important task is to verify information companies provide to the outside world by using several different audit tools during execution of audits. Digitization will be in so way to investigate which of these audit methods can be automated in an appropriate way and what are the IT tools SMPs are utilizing while conducting audits and other services.

Informant E has working experience in different audit firms including big 4 audit firms. He explains that most of the SMPs do not embrace latest technology and do not willing to use audit software. Most of the audit firms are only using technology to maintain audit documentation without any involvement of technology during the performance of the audits and execution of audit is still manual. Even top audit firms of the country are still using excel based files to attach in their audit software. Audit “through the computer” in which audit is performed through clients’ data in the computer without checking the physical vouchers is very less in Pakistan whereas most of the audits are being done “around the computer”. If information system general controls are found better, then auditors rely on system generated reports otherwise they do not rely on management reports. Even some clients in Big 4s have implemented ERP (integrated) software system in their companies; but still auditors are conducting audit procedure manually. Although, data analytics are being done very efficiently through MS excel by using different formulas, filters, and techniques.

“.....may be in future we have to update but the main concern is that our clients are small, if they would adopt more IT in near future, then we can think about more IT tools. Currently I don’t think that due to less technology we could not innovate in our services considering our clientele base, but how to use the existing technology efficiently is more important than new technology and we believe that we are using existing technology tools in an effective way to perform our tasks.....Investment in technology and new services is a gamble of investment of financial and dedicated human resources.” Informant B

When informants were asked about the use of any specific audit software for efficient and effective performance of audit engagements, all respondents replied that they are still not using any audit software during execution of clients’ audits. Some participants have also worked in big 4s so they have experience in both types of the audit firms and can provide their comparison of audit practices in Big 4s and SMPs. As it was informed to us that SMPs do not have any special audit software as big audit firms are using to standardize

the audit procedures, Authors of this thesis explored the main reasons why SMPs audit firms are not interested in adopting audit software during audits and why these firms do not feel any pressure for more sophisticated and tailored made audit tools for efficient working to save their times and resources.

Informant C explains that utility of advance audit tools is limited when compared with heavy investment involved in procurement of audit software from vendor, because his audit firm has small audit clients with less complicated operations. Competent auditors can easily apply audit techniques and other methodologies efficiently with the usage of simple and easily available software such as MS Excel to reach the final output. Most of their audit program and other working for new services are conducted in MS Excel and it also helps to handle large data of their clients efficiently and conveniently. Currently they are maintaining manual documentation and performing manual audit procedures to verify the clients' financial information.

Informants share varied reasons why their audit firms are not using audit software. Informants F, G, H and J share their thoughts that they know the importance of audit software but they perceive such audit software are expensive for them and they have to pay subscriptions and update & maintenance fee afterwards to vendor, which carries cost and they do not expect this audit software cost they are going to recover in the near future, because their audit clients are mostly small, less risky (family owned businesses) with simple operations and pay less audit fee to audit firm. Mostly clients have better control over their business activities, so they take audit as a cost just to fulfil regulator's requirement. Trigger point is that audit firms have limited number of audit clients and mainly their clients are related to advisory and tax services. The same informants also express that implementation and update of audit software require trainings to all staff including partners which can be assumed as hindrance for senior partners as some partners are senior and have much previous experience in manual auditing and they are comfortable in this auditing. They also support the availability of cheap labor in the country so they can hire more human resources instead of uncertain modern technology.

“.....No body approaches me to market or sell audit software by convincing me about the audit software features and efficiencies than the traditional audit procedures. I don't know how audit software will help me during audits. ICAP was thinking to provide us cheap audit software but till now we did not get any update regarding audit software. It depends upon clients' data, if I shall get very refined data from client, then may be audit software helps us to save our time.” Informant J

Informant J explains in detail to our query regarding audit software. He narrates that during audits, most of the data auditors get either in soft-form or hard-form and this data is not integrated with other institutions like in developed countries. They spend most of the time in ensuring the completeness and authentication of data got from the audit client, for example, ensuring clients' bank balances and reported transactions in the clients' record are accurate or not, due to the reasons that systems of different institutes are not integrated so audit firm has to confirm the transactions from various sources which take extra time during audit. Financial statements submitted to the banks by client for loans related purposes are creative accounts (with high sales and fake bank balances) which are made intentionally to get the loan from the bank, so these financial statements are not considered reliable. That is the main reason they spend more time to ensure whether reported transactions are genuine or not. Even medium firms are also conducting their audits by using MS excel without utilization of any audit software. Auditors have reactive approach because they have to apply audit procedures on the data and record provided by audit client and mostly customers' record is manual based, or system generated hard report without any soft form, so it does not make sense to input these manual data into audit software before conducting audit by auditor. If auditor gets consistent type of soft data from client which can be used later in audit software, then audit firm can think to buy audit software to make their works more convenient and efficient. The same informant explained in this concern that they have also cheap labor available in the country like other South Asian countries, so they utilize more human resources without relying on expensive software. Lastly but most importantly, he shows his concern that his audit firm has only three audits in the entire year, so it is not cost effective and wise decision to buy software for less usage by the audit firm.

Informants I and F have audit experience in big 4 audit firms and they explain that big 4s have audit software comprising checklists which helps them to audit as per standards and uniform methods. Whereas small audit firms do not have any audit software and they conduct the audits manually by using MS Excel and focusing on main risky areas and important critical points in each audit area. They totally rely on auditors' skills and judgement and think that competent auditor can conduct audit subjectively without any formal mechanism but at the same time there may be a chance that audit staff may overlook un-deliberately some important aspects during the audit planning and other important audit procedures. Auditors in SMPs may try their best to ensure that all audit procedures are being complied to maintain audit quality but sometimes they cannot match their working with quality audit

produced by audit software being used by Big 4s audit firms. They state that audit software is considered as a big gap regarding audit execution between big 4s and SMPs. They express that their audit staff are competent to make audit planning as per customers' profile by using available IT tools, in this way their staff has better control on prevailing IT software whereas audit software in Big 4s decide about audit program. Big 4s mostly rely on audit software; they have perception that software guides the auditor to audit so auditor with comparatively less experience can use the audit software to produce the almost same output as competent auditor can conclude. So, they think that auditors in the Big 4s are decreasing their decision-making skills due to over reliance on technology and checklist audits may cause in deskilling of auditors in big audit firms. In SMPs, auditors learn how to balance audit execution efficiently within specific deadline.

Informant I explains that Big 4 audit firms calculate materiality from audit software and apply all audit procedures as per this materiality level. Audit software helps as well as controls the auditors to ensure performance of important audit tasks completely. Whereas SMPs do not have audit software so there may be some doubts of accuracy in their audit procedures due to manual audit planning and audit program, and mostly it depends upon the auditor's subjective and skeptical judgment how to conduct audits. Audits in small firms involve more hard documents instead of software form and maintain manual file containing documentation. Sometimes it may be difficult for auditor to maintain balance between audit quality and independence while conducting audit of close customer because auditor can soft their audit approach by trusting the client and may reduce their sample size because he is not bound by any software and may skip important procedures, and this may impair his independence as an auditor. Informant I thinks that lack of software in SMPs may help to easily impair auditor independence as compared to big audit firm using audit software.

Informant F also explains critical point about the usage of MS excel that standardized audit software can restrict their sampling and audit planning which auditor have to follow during audit and auditor cannot change easily these system generated audit programs unless major changes in the process or client profile, whereas in MS excel auditor has whole control related to audit planning and sampling and can make uncontrolled changes in case of frauds to be highlighted in future and to avoid from review from ICAP quality control team. Non-adoption of audit software may help more to SMPs to safe their skin in case of any review of their audit quality.

Some informants express their future concerns about technological advancements in the audit industry.

“There is a need of affordable technologies for SMPs to a opt new technologies matching clients ITs. There should be advancement in the technology which can be afforded by small firms. If they are not able to adopt new technologies their market will be limited, only small SMEs without sophisticated IT system would be their customers. As world is uncertain, so we have some fears related to IT development, so we should learn also new technological tools.” Informant A

Informants A, B and I show some fears related to IT development in SMPs and they realize that audit industry is lagging in IT and they should embrace technology with the changing world. In other words, customers’ preferences have a major impact on the digital development of small and medium-sized auditing firms. All informants explain that most of their clients are not using more sophisticated IT tools, so audit firms are more reluctant towards new innovative technological solutions. They have no technology pressure from clients, so they have adopted reactive approach towards technological tools. They are more relying on to exploit the existing technological tools and software up to maximum extent.

Our findings show that even though the usage of audit software and other sophisticated IT tools is limited in SMPs, but still digitalization facilitates in the development of new services in SMPs.

“.....We have remote access to the online and customers’ software and these kinds of remote access facilities have changed the ways of interaction with customers and doing businesses. Digitalization helps to create new markets, new customers and ultimately new services.” Informant C

Informant C expresses his thoughts about new services in the market by stating that online technologies and social media help them to reduce the gap between client and auditor. Technology helps clients to consider outsourcing more important than before, particularly due to COVID this becomes an opportunity for audit firms in the current crises. Audit firm is helping their clients to make their accounts through easily available and cheap online accounting software. He explains that some clients have outsourced their accounts and finance department to the audit firm, so clients send daily sales and expenses vouchers by taking pictures to audit firm through WhatsApp / different apps facility which is possible owing to technological advancement, and audit firm staff maintain clients’ accounts without visiting their premises.

Informant D explains that his audit firm has separate IT department whereas most of the SMPs do not have any separated IT department. His firm is also providing IT services to the clients apart from other services. He explains that firm partners have good relations with customers as their external auditors and they are convincing them to implement specific software in their businesses, so they are trying to sell their software to the clients. Most of the audit firms are only providing quick book software services to their clients but his audit firm is providing three modules (Inventory, POS, and general controls) software services to the clients. They are providing almost all the services like installation of accounting software, maintenance of software, bookkeeping, and external auditing to the same customers due to strong relationship with the clients. They are also providing bookkeeping services to many customers like informant C has reported, so they are utilizing digitalization efficiently to innovate new services and they are earning more of their income from IT related services. Due to more IT services, their clients are more dependent and loyal to the audit firm.

Informant E explains that the outsourcing business in SMPs is in more demand. Due to cost efficiency and globalization, outsourcing services awareness is now more in the market. As technology has currently evolved many firms from Australia, Europe, USA or other developed countries are making their back offices with the partnership of local audit firms in Pakistan due to cheap labor available in the country, which is only possible due to digitalization, it can be a sort of service innovation for audit firms in Pakistan. In Pakistan, chartered accounts are less paid when compared to international market so many SMPs are focusing on international business and services. Like virtual CFO and BPO (Business Process Outsourcing) services are introduced in recent years in the market. Mostly firms are doing BPO (Business Process Outsourcing) and even small audit firm is generating almost PKR 4 to 5 million monthly revenues from BPO which is handsome income for a small audit firm. After COVID, outsourcing and such kinds of online services have become more common in SMPs due to reliable source of revenue generation. Consultants are providing services to different clients while seated in their own offices and technology has helped SMPs much in this respect. Informant F's audit firm is handling American clients online by providing accounting and auditing related services whereas Informant G are conducting audits of Australian customers and all execution of audit is done in Pakistan and only final audit report with necessary supporting is sent to main Australian audit firm for final sign off. Australian audit firms are outsourcing their audits to Pakistani SMPs and such SMPs

are more interested in international business instead of local clients. Informant J audit firm remains open 24/7 and employees are working online with different clients around the world. All informants are utilizing existing technologies to create new services to new and existing clients. Existing technology is still very helpful and handy for them to approach to international market.

4.3.3 Human Capital

Our findings show that human capital is the most valuable resource for SMPs being knowledge-based firms and especially crucial factor towards creation of service innovation. Informant A explains that employees in his audit firm play a very crucial role in the creation of new services and improving the existing services.

“Technology only helps in the process, but innovation comes from people. In most of the services provided by our firms, our knowledge and competency improved the services without any change in the technology. We have to compatible with the clients’ technological environment, and our clients are simple without any integrated and complicated IT systems, even some clients are still maintaining manual registers, so in this case employees perform the assignments without any help from automation. We sometimes think that our audit staff are more competent than big 4s because our staff practically learn more from different scenarios in the field....”

All Respondents inform us that audit firm helps the clients by providing solutions of different as well as unique problems, through which they create innovation in their services. They provide different services to customers to protect them from regulators. Sometimes, their (less educated) customers with notices from the regulators approach them for services so they respond the regulators on behalf of the clients or help the clients to ensure regulatory compliance.

“.....we are unaware and have less expertise in the new tax matters raised by the regulators, but we respond by updating our self and cope new assignments through learning new skills, with the main purpose to retain the customers.” Informant B

Seven respondents (A, B, D, E, F, G and J) share their thoughts that sometimes they accept assignments from customers without much relevant experience and surety that they can perform these new services successfully or not, and this is common in SMPs. Respondent E accepts some different assignment from clients and later they hire technical staff to manage such assignments. Respondent G accepted some Australian client for auditing services from an Australian audit firm without having any basic knowledge about the Australian market, but

later they performed these services by updating themselves. All informants add that in some areas they have less expertise, but they manage to respond to the customers by updating themselves, being part of knowledge-extensive occupation.

Informant A, B, C and H explains that during external audit, auditor may identify loophole or gap in the client's business which require more assurance from auditor and this gap can be filled through other services than external audit. Auditors may perform such other services if these new services do not impair their independence otherwise, they refer these new services to other audit firms or partners. These kinds of other services are innovative services for some audit firms. Informant C explains that he, as a partner, is always looking for to provide new services to the clients. Recently audit firm introduced stock care services and convinced their customers to give responsibility of their stock-check permanently to the audit firm. This will provide better control to the client over stock as stock is very expensive asset for the client and auditor has generated new services in this area. Previously auditor only counts clients' stock on year end to ensure existence of complete stock, now audit firm is providing more control to customers over their sensitive and expensive stock.

Most of SMPs are focusing on niche markets as they have developed skills and new services in the specific sector, so they try to find more customers in this specific area, for example, respondent J is providing some technical services in food industry whereas respondent A is stronger in construction sector. One of the partners in the audit firm of informant F is providing different services to specific type of clients in USA.

Overall, all firms except respondent D's audit firm have good and open culture which facilitates service innovation in the firms. Employees share ideas for new services and partners and other staff have frequent meetings and connections for development of new services. Respondent D is of the opinion that their partners have more bureaucratic style, and everybody has to follow hierarchy and they cannot discuss new idea of service innovation with their partners.

Informant J shares his new business ideas and states that they are more updated about government policies and regulations than their small customers, so they are more aware of new business opportunities in the country. They can capitalize their own knowledge and skills more effectively in the practical field as they can share new business ideas with the small businessmen and can create new services for the audit firms. Recently he convinced a client to establish manufacturing plant in Pakistan upon which government will provide the client subsidy facilities. Informant E is working on unique project and new business chain would be developed in Pakistan, such services by audit firms are not related to traditional

work of audit firm but SMPs are enjoying unique projects through their role as advisor to the clients.

All informants express that staying up to date is a big challenge for employees in SMPs to keep the firm in business. They need to be updated regarding new regulatory requirements and should inform their customers about new requirements and developments. Sometimes update of knowledge helps the SMPs to create new services in the market in the shape of new assignments. Partners of audit firms have to balance their role as developers of new services in the market as well as strong grip on the updated technical knowledge. Informant G share that knowledge update is now more vital to remain in the market and get success in the business. Previously, one partner can provide different services like auditing, tax, and consultancy, but now compliances and regulations have become so strict and complex that specialization is needed in each area, even tax department has been further divided into sales and income tax. Now, mostly firms are run by three to four partners with specialized expertise in different areas. Informant G expresses like this that if clients get apprehension that audit firm staff are not updated then clients shall never approach them for quality work and solutions of their problems. Updated auditors make strong bonding with their customers and keep their clients more loyal to them.

Informant A shares that if senior staff in audit firm leaves the job, innovation activities may be affected. But mostly senior permanent staff in audit firms do not leave audit firm much frequently. Turnover rate in permanent staff is low in their firm, which helps the audit firm to create new services at ongoing basis. They are thinking about different areas and sectors for new services, if in one area, services are reducing, may be due to technology or other reasons, they are planning and accepting challenges to create new services in other areas.

All informants have the same opinion that most of the brilliant CA (Inter) students are willing to join the big 4s due to more learning opportunities in big firms and mostly other students who take more attempts to pass CA (Inter) join SMPs. At the time of hiring SMPs generally get less quality staff from the market so these staff with less motivation is not more open for service innovation in SMPs. All informants show their concerns about lack of training in SMPs due to shortage of resources. SMPs do not invest in employees and no formal planning and strategies are available for training of employees and human resources. Further, almost all firms hire student from CA (Inter) background without mix of students from different background, especially neither IT people prefer to join audit firms nor audit firms are looking

for graduates with IT background. The same caliber of people can also restrict service innovation in SMPs.

Five informants share that, young partners are more willing to innovate new audit procedures and introduce new products and services, but old partners are not comfortable with IT, so they are reluctant to implement novel solutions and innovative ideas for service innovation. Whereas informant D expresses that both of their partners in Lahore Office are old, but still, they are active in implementing new IT solutions to fulfill customer's demands.

4.3.4 Customer's Demand

Our findings show that the customers demand is a crucial factor in development of new services. Respondents inform that most of time customers' needs for unique services create service innovation for them. Customers discuss their business-related problems with the auditors and auditors suggest different solutions and advice to them through consultancy and other innovative services.

Informant G states that customers' needs develop new service for them, auditors try to convince customers about new regulations and requirements in the business but most of the customers do not take auditors advises seriously in the beginning and think them as cost aspects, but when clients have very urgent requirement, they move to audit firms for solution. Customers do not approach to audit firms until something happen out of their control, like fraud, regulator penalties and legal actions. Informant H explains that top management of client business are aware about all gaps in their business so mostly clients approach us with more risky area to probe in detail due to shortage of competent clients' staff, so SMPs investigate this area in detail as per clients' needs. Clients need unbiased report from an independent authority (audit firm) and majority of new services are being created upon clients' needs.

Informants B, H, E and F explains that in the last few months, frauds and dispute related matters among partners created new assignments for the audit firms. Informant B refers an example of sugar mills where dispute arises between family members. Due to COVID, performance of business goes down, and which deteriorates the trust level among partners, so partners need third party assurance from audit firm. This pandemic generated new service for audit firms.

Informant A shares his thoughts that during external audit clients are close to the auditor due to frequent meetings and customer may share his business problems and needs with the auditor which may be a source of service innovation. Informant B and C states that clients take them as advisor and discuss new business avenues and opportunities, tax complications and financial compliance matters for advises. Auditors try to fulfil different customers' needs by providing customized services to them which may involve service innovation.

All informants state that their customers are small businessman, so they prefer to approach their audit firms instead of big firms because they are in better position to understand their clients' businesses. Most of the times new customers approach the audit firms for making accounts from zero, because they never make any accounts previously. Informant D and F share that mostly they are fulfilling all needs of their small customers through one-window operations, like they are their external auditors, and they are also providing them sales tax, income tax and withholding tax services and process management services. They are providing bookkeeping services to their small customers and audit staff visits the client once or twice in a week for few hours to maintain their accounts in the system.

Informants B and D share that they are more focusing to get new service assignments from different institutes through bidding process, as sometimes. regulator's need is to get independent and unbiased opinion from audit firms. Informant D explains that, his audit firm has separate specialized department to get different assignments from public and private sector through proposals, other than accounting and auditing and they bid for new services to be provided to these government departments or private organizations. They offer low prices in these bidding to win the project in the competition. Audit firm has low paid CA training students with monthly salary of PKR 13,500 (almost NOK 750) and they engage them in these consultancy assignments. These kinds of services generate handsome revenue to the audit firm whereas against these assignments they bear low cost; they utilize their staff efficiently in these unique services. They get different and unique assignments through such kinds of proposals, recently they conduct an assignment in which they measure area sizes of actual plots / land areas and compare these measurements with the government (Excise and Tax Department) record. Audit firm has more than 100 CA students so cheap labor is available to the firm, so they try their best to have different assignments through lowest bidding whether relevant to audit / accounting or not, because they have to utilize their human resource efficiently.

4.3.5 Government Institutions Compliance Pressure

All informants explain that SECP and FBR are active government bodies nowadays in the country and making strict policies for the small businesses to cover them under the tax bracket, previously small businesses were enjoying many tax-free services. In the last few years, new government made rigid policies for compliance purposes so many customers are forced to comply regulations to avoid legal actions against them, so they are approaching to the audit firms to make regulatory compliance.

Informant B states that auditors guide the clients to follow the regulatory tax compliances and other requirements to avoid penalties and legal complications. Tax regulations are changing; these changing regulations can become a cause of new services for innovation by audit firms. Like, every NTN holder must file tax return and every property owner must file income tax return. New Government elected in 2019 is emphasizing more seriously on tax collection from businessmen as compared to previous governments, so this government has made the tax policies also tighter for small business to collect several types of taxes from the public. So, a lot of small businessmen are approaching to audit firms for the way-out to avoid tax authorities' notices, penalties, and legal action. Tax filers have more advantage like fewer charges and tax rebates on banking and other property related transaction. Such kind of rigid policies from regulators on different businesses has created more consultancy and tax services for audit firms, as now small audit firms are providing tax services to small businessmen who never registered themselves for taxes earlier in their life.

Informant A explains that regulators trust more on auditors reports as an independent authority, and they try to involve auditor in many ways. One reason may be that systems are not integrated and not much IT oriented general controls (more manual record & less automation) are implemented being the developing country, so SECP relies upon auditors' reports so many requirements of the SMEs to be filled through audit firms. For example, recently a new instruction has been passed by SECP through company act that a newly established company must provide a confirmation certificate from auditors that they have sufficient balance in their account to start a company. In this way a new service has been created because of regulator.

Informant A comments that regulations have created much influence on new services as regulators demand new services from auditors. For example, like all over the world,

regulators in Pakistan are also working on FATF and it is anticipated by the audit firms that regulator will add auditors in the process to give opinion so it may be added as new services by incorporating FATF subject in the audit financials of clients.

4.3.6 Strong Auditor – Client Relationship and Trust

Findings show that strong relationship with clients and trust is an important factor for service innovation. Informant B explains role of trust in service innovation and highlights some key points in this regard.

“I think strong relationship with customer is a key for new services, customers blindly trust us after a specific period when they have got belief in our competencies and guidance. Through trust and profound understanding of client business, we are in better position to propose new services to existing customer. In trust, customers get one-window operations which is convenient for both parties. Trust also helps us to create the balance between our economic objectives through different services and customer’s requirements. Sometimes we know weak points of the clients and customer don’t prefer to move to another audit firm. Client retention is the key for our firm success and continuous relation with customers through different assignments convert the relation into strong trust. If we rely only on external audit, we meet customer just almost two months in a year. Through external audit, we cannot create good relationship with the customers. While during other services, we have more opportunities to meet our clients.”

Informant A, B, D, F and G explains that audit firm has good relations with most of clients and clients consider auditors as their priority to get advisory services. Some businessmen do not have better IT systems and often audit staff from the firm visits them to make their financials. Through networking and good relationship, new customers are also referred to the audit firms for solutions of their business problems. Close client relationship and trust is developed with quality services to the customers and is also very helpful in the development of new services. Once trust develop, client remain loyal unless need of unique service to make him move to another firm.

Informant A adds, if client needs certain services which they could not provide, client request them to refer him toward better other audit firm for this specific service because client trusts them. Mostly clients trust auditor recommendation / reference due to good relationship. Their relationship with client is at good terms and very professional, but not like friendship because

it might hurt their independence as auditors' independence and ethics should not be compromised.

Informant C states that relationship with customers depends upon what kind of services audit firm is providing. If they are conducting external audit, then for sake of independence the relationship will be different but in case of other services relationship will be stronger. Trust plays a significant role in innovation for example if they see the relationship of a lawyer and his client, the client provides complete details of its case if he trusts his lawyer, the same applies with small audit firms. Trust is developed with confidentiality and without trust small firms cannot gain complete information regarding customers' needs and cannot develop new services to fulfil the needs. Informant E explains that if customer does not trust the auditor, they will be hesitant to get a service. With proficient level of trust customer starts to depend on audit firm and start asking for new services.

Informant G has audit experience in Big 4s, and he shares his thoughts that person with the experience from big 4s when start his own audit firm has more hurdles in the beginning because he does not have strong relationship with the customers as compared to person who has worked in small firms and has already developed strong relationship with the customers. Auditors in SMPs are managing their customer portfolio and involved also at the management and execution level of the assignment so they have better chances to build their entrepreneurship and relationship skills whereas in Big 4s different departments are involved, like one department is doing contracts with the customers and other department is performing audits.

Informant B, C, G and J states that their relationship with the customers and quality service to customers become their main marketing tool to attract new customers in the market. If their existing customers are satisfied, they refer us new customers. Networking and referrals help them to get new services from the market.

Our findings show that for SMPs it is difficult to maintain their independence because of limited clients. To retain those clients and be profitable sometimes they have to compromise their independence. Informants C and F explain that in terms of external audit the auditor has to follow the regulations and has to be independent, if auditor identifies some errors, they report it to the owners and they take it positively but sometimes auditor faces pressure from client or partner not to highlight critical issues in audit reports.

Informant B states that client's approach to the audit firms and small audit firms have limited number of customers so they have to generate maximum revenue from such customers by retaining them in long term relation. Small firms try to provide maximum services to satisfy the customers which may impair their independence. It is difficult for SMPs and especially for non-QCR small firms with less quality review pressure from regulators, to maintain balance between economic benefits and independence. Audit firms need clients whereas clients have a lot of firms to get audited at low fee. Regulator should depute an auditor to a client to observe independence instead auditor approach client for marketing of external auditing services. But our findings show the otherwise, as informant D explains that sometimes his audit firm tries to convince its customers to avail all services from them, because it is the matter of business for them, informant knows five to six customers, initially audit firm was only clients' external auditor, then they convinced their customers to use their software and provided them book-keeping services. They tried their best to provide all services to their customers to build strong relations with the clients and clients' dependency upon audit firm.

Informant F explains that recently few months ago in Nov 2020, ICAP issued a circular to review small firms' audits once in a year. Small firms were not expecting this ICAP move so most of the small firms are intending to leave the auditing industry due to the pressure of ICAP and some small firms are trying to follow proper audit procedures which they were not following previously. Some small firms are issuing financial statements to customers without actual audit by charging reasonable fees. Small audit firms give favor to small clients to get business as being chartered accountant firm, audit employees are more competent in accounting entries and know very well about loopholes in the transactions so they guide their customers, which may impair their independence, and later through documentation small firms are able to save their skin and auditor use "test-check basis" terminology to make themselves secure from regulators.

Informant G having audit working experience also in Big 4s states that quality of audit report depends upon partners who sign the audit report and approve the audit assignment. Big 4s have to follow protocols and standards of international affiliated bodies, these international bodies in addition to ICAP are also reviewing quality of the audit so big 4s have to maintain audit quality. Sometimes, audit quality depends upon the requirement and purpose of the audit in small firms as some small businesses need audit report just to apply for bidding and tender etc, without any regulators needs. So, different purposes and factors of clients are

involved in audit reports which decide the quality of the audit in small firms. He thinks that auditors in SMPs can impair their independence more quickly than big 4s. This indicates that quality of audit depends upon the factor, auditor asks the client before commencement of the audit about the requirement of the audit, if its regulatory requirement then auditor in small firm try to maintain quality, if he knows that he will not be asked for the audit by any regulator, he may compromise his independence and can issue report without applying complete procedures.

Informant 'I' also has big 4s experience and he states that partners in the audit firm are in good relations with the customers and guide their clients in covering critical points highlighted during audits by providing solutions and increase their audit fees for such guidance services. Because small firms have fewer clients, and they are depending economically on few customers, so auditors help them to cover the issues and, in these situations, there is a much chance for impairment of their independence. Documentations are prepared by clients upon guidance of auditors in such a way that such kinds of issues are difficult to be highlighted by ICAP quality control team during their visits. Informant H also share same comments as informants I and G that due to strong and close relationships with the customers, they struggle to maintain balance between audit quality and professional independence.

Informant J states that audited clients are less in the market so due to competition, mostly audit clients are retained due to references instead of quality. In SMPs client-auditor relation is more important than quality of work because if clients need quality, they will go to big firms. ICAP has fixed minimum audit fee of PKR 75,000 to be charged to client to maintain quality and independence and under-cutting is not allowed in audit fee to restrict competition in audit firms, so through this requirement auditor cannot quote less audit fee than last time. Whereas actual practices are different in the market, as some small audit firms are involved in malpractices and charging undocumented less audit fee (may be PKR 25,000) than minimum fee of Rs. 75,000 without adopting proper audit procedures as per guidelines and may compromise audit quality. He adds further that auditor issues three audit reports to the clients of same period, one for bank, one for tax authorities (FBR) and one for routine use. Whereas only one report should be issued to the client and the same should be available on ICAP / SECP regulator website for easy access. There are more chances that small firms can impair their independence so easily than big 4s due to audit fee, small number of customers and strong relationship with limited customers. Our findings show that to retain the

limited clients and to survive SMPs tend to compromise their independence and they are more focused on the other innovative services rather than audit services.

5.0 Discussion

In this chapter, we will analyze our empirical findings and discuss critical findings against the theoretical frame of reference which is the basis for the thesis and get the answer of the problem and research questions.

5.1 Service Innovation as a matter of Survival

SMPs are not working in their specific spectrum as previously audit firms were only accepting assignments related to accounting and auditing, but now employees in SMPs have aggressive approach towards business opportunities and they are thinking out of the box to explore different avenues in the market with the motive to achieve economic benefits. Key management in SMPs want to catch different dynamic business opportunities by utilizing their knowledge, skills and learning capacities. This implies SMPs decision to adopt and use service innovation as the best course of action in the current scenario in the country.

Our empirical data show that being external auditors, SMPs have less chances for innovation due to standardized audit procedures and methodologies as well as independence rules, but in other services like advisory and consultancy SMPs have much room for innovation as new services are kept developing in this area so they are capitalizing opportunities in such area and creating new services and / or providing unique services to customers to fulfill their needs. Service innovation in external auditing happen only after couple of years when regulatory and professional bodies see these new procedures very indispensable to deploy in audit procedures. Our findings are supported by literature as Kang et al., (2015) and Peecher et al., (2013) argue that legislation encourages auditors to perform defensive audits. They believe that accountants focus on only traditional general accepted audit procedures which counteracts introduction of innovative solutions. Audit procedures should be extensive as well as in details, to highlight the scam (e.g like Enron) during review of clients' record but should not impede innovation and new development during practices. There is need in literature how to balance both approaches as an auditor.

Regulators in Pakistan have developed audit market in such a way that mainly suits to big audit firms and big audit firms can easily manage to get audits of many sizeable, listed audit client and SMPs have access to few listed audit clients left over by big audit firms. SMPs can get only a small share of audit clients from the market, so audit services are not a main source of revenue generation for SMPs when compared to big audit firms. SMPs are primarily registered as external auditor with ICAP, and they know that as external auditor they cannot

compete big audit firms due to their reputation, sufficient resources, international affiliation as well as regulators more trust on big firms. SMPs have access to limited number of audit clients so they have two options for their survival, either to produce quality audit after deployment of quality staff & other resources to compete with big audit firms or to explore other services and opportunities which can contribute toward their survival in the industry. For survival and maintain their existence in the market, SMPs in Pakistan are focusing more on other innovative services rather than audit services as per our empirical data. This also relates to the literature (Singh et al., 2020; Storey et al., 2015; Tajeddini et al., 2020) as SMPs like other firms have broadened their range of services and considers innovation important to remain competitive for their existence and profitability.

SMPs are in dire needs of new services and opportunities in the market so they are ready to accept new assignments from the customers without having any previous expertise in the concerned area with the motive to explore chances of more income streams for their firms as well as to satisfy their customers. This can be explained more explicitly that non-supportive regulators-built environment for small firms in the country and economic survival element has been accumulated and created very strong internal stimulating factor within the small audit firms which act as spur to service innovation. SMPs have developed strong cultural environment within themselves which remains them stimulated for innovative services. If SMPs cannot create new services from the market they may attract their demise. Other advisory and consultancy services are more innovative and have more chances of service innovation so new services are kept developing in this area by SMPs. It coincides with literature as well, and according to IFAC report (IFAC Global, 2018), 86% of the SMPs services are advisory services other than traditional services of SMPs.

As per empirical data, customers' demand is a crucial factor in the development of novel services and customers' demands drive the SMPs market for creating new services. Customers' requirement is necessary for the successful exploitation of new services ideas. Without consumers' uptake and absorption, innovations cannot be viable. Clients approach audit firms to discuss their business-related problems for customized solutions and clients' needs become business opportunity for audit firms to create new services. So, audit firms develop new skills and expertise with the changes in the market and customer's needs drive them to modify their business models to respond the market effectively. SMPs consider the significance of customers' needs which can trigger the service innovation process. It relates to the literature as describe by Kandampully (2002) that service innovation generates only when

a firm can deploy its maximum energies and efforts to think on behalf of the customers. Clients' demands drive the behavior of the audit firms, and these firms' employees recognize the needs to develop innovative services to satisfy customer demands in a responsive and timely manner which coincides the literature (e.g Alam, 2002; Lovelock et al., 2001). SMPs realize their success by listening to the customers' requirements while anticipating, initiating, and developing innovative, and value-added services that drive the market and such SMPs' services offer superior value to the clients.

Moreover, customers with unique and different problems approach to the audit firms for services and SMPs have never experienced such services earlier. So, audit firms take these new services ideas overwhelming and respond to the customers through utilization of their learning abilities. This process may involve co-innovation where both parties play their important roles in creating service innovation. So, customers' demands, and needs can be considered as important external pressure to service innovation and SMPs respond this pressure through best available consultancy services which help them to improve and maintain their performance in the market. If SMPs will not respond to their customers effectively they might lose their market share, and ultimately existence. This explains that firms innovate due to different pressures from external environment as well as internal chosen strategies. Small & medium audit firms adopt innovation with the intention to ensure adoptive behaviour for changing themselves in order to improve their performance which is supported by literature i.e Damanpour et al., (2009). SMPs contribute in innovations to succeed, use efficiently the scarce resources, meet customer demands, enhance service quality, obtain different skills, and reach their goals. This corresponds with many researchers such as Baregheh et al. (2009), Damanpour (2009) and Iden et al. (2003) has highlighted the reasons and importance of service innovation with respect to clients' needs.

On one side rigid audit procedures do not allow much innovation to SMPs in their ways of performing core work of audit and on the other hand they have limited audit clients market due to dominance of big audit firms in capturing big audit clients. So SMPs are left over with the option to explore innovative services in areas other than external audit to maintain their survival in the market. In fact, SMPs are more enjoying innovative services in advisory and consultancy area and have also touched international markets and now they have clients all

over the world. Both internal and external elements made SMPs to think more seriously about service innovation without having any other better alternative course of action.

We can conclude that SMPs in Pakistan are balancing both internal and external pressures with the ultimate objective toward survival in the market. Literature has already been found where external pressures especially clients' needs has been discussed for creating service innovation but internal element for service innovation like in Pakistani SMPs are relatively scares in literature so this research study can contribute to the literature that how small service providing firms can balance different pressures for creating new services in the developing economy.

5.2 Innovating for Service: Human Capital, Not Technology

Our empirical data indicate that human capital is a pivotal factor and resource for service innovation in SMPs. Real innovation comes from the people's minds not from the technology, as sometimes new services are being created by SMPs without involvement of much technology. Human capital is in better position to decide which technological tools and type of technology is most effective for their audit firms to execute their performance in audits and other assignments. In SMPs, partners and employees of firms are closer to the clients, so they understand very well the technological and other business needs of the clients, so they try to update themselves to be compatible with the clients as ultimate objective is to retain the clients through quality services by SMPs.

SMPs are knowledge-intensive firms that offer employees' technical expertise with updated knowledge to the clients, and these are considered as a valuable resource for the firm as literature (e.g Alvesson, 2004; Starbuck, 1992; Fosstenlökken et al., 2001) also support employees' expertise as key factor which can provide the firm long term competitive advantage, as tacit knowledge is difficult to copy. This also relates to what Ahonen (2000) says that human capital is the only intangible asset which can be acquired within the company and can consequently be called a generative intangible asset.

Our empirical data show that SMPs are willing to accept unique assignments from the clients without having any relevant previous experiences and employees in SMPs have the more confidence upon their competencies and skills that they can accomplish such new projects successfully to explore innovative services. Employees at top level in SMPs consider themselves as learners in the practical field and try their best to be updated about regulations, markets, and customer's needs. This indicates that SMPs' staff members are

seemed to be key contributor in responding to the environmental factors by providing new services and top management in SMPs always looks motivated to offer new service to their clients to maintain their relations with the clients which is also supported by Damanpour et al., (2009) where leaders motivation for innovative services has been mentioned.

To complete unique tasks accepted from the clients, they can hire services from other professionals with required skills and competencies. This indicates that in case of unique services and projects, employees in SMPs are willing to work in heterogeneous teams with the motive to create service innovation as well as learning. Literature (Andriopoulos & Lewis 2010; Beckman, 2006; Lavie & Rosenkopf, 2006) also support our SMPs practices that degree of innovation is affected by how a project team is put together.

New services are created and decided through ad hoc process in SMPs, and some formal procedures are involved but employees in SMPs do not document these decisions making and innovation development process, whereas they discussed every service innovation among partners and seniors before its launch. Employees in SMPs scrutinize the important aspects in this regard. According to our findings, SMPs are following professional service process as prescribed by Sundbo & Gallouj (2000), and to be more specific they are creating new services through ad hoc process. Our empirical data coincides with literature as Jon Sundbo & Faiz Gallo (2015) describes that in service professional process, the main lever or driving force of innovation is individual competencies and expertise which suits to the service-professional trajectory. Interaction of employees with the customers is an important locus of innovation. SMPs continuously perform incremental innovation, minor changes based on existing technology, knowledge, or activities. These changes are often developed to meet the needs of existing customers.

Our empirical data show that most of SMPs are focusing on niche markets as they have developed skills and new services in the specific sector, so they try to find more customers in this specific area. Small and medium sized audit firms' top management desires to introduce new services for existing clients and markets or to find new market niches for already developed services. This indicates that specific developed skills of SMPs employees help them to get competitive advantage in the specific market. This also relates with literature where Littlewood (2004) explains that human capital ensures firm's competitiveness.

As per empirical data, update of knowledge helps the SMPs to create new services in the market in the shape of new assignments. Partners of audit firms have to balance their role as developers of new services in the market as well as strong grip on the updated technical

knowledge because SMPs do not have separate learning and development department due to lack of financial resources. Staying up to date is a big challenge for employees in SMPs to keep the firm in the business and be able to create innovative areas. Key staff has to perform their daily activities as well as to acquire new skills and updated knowledge. Our findings show that staff in SMPs has to put more efforts to be updated themselves about the changing regulations and requirements. This indicates that human resources in SMPs including partners have multitasking ability to create and perform innovative services simultaneously with their routine daily activities. These empirical findings are in align with Sundbo et al. (2015) who uses the term “Multitasking” explaining the employee’s role in the service industry.

Our empirical data show that lack of training culture and less professional & IT environment in SMPs make these firms unattractive for most of new students and other junior staff to work in such SMPs. Employees in the SMPs do not see their long-term career in the SMPs due to such factors, so they take experience from the audit firms and try to get better jobs in big companies. Chen et al. (2012) points out that when knowledge workers leave a company, this leads to a loss of intellectual resources, so turnover of employees may reduce the ability of SMPs to innovate. As per our data, partners and top management in SMPs are more associated with the same firm for longer period so they remain a main source of service innovation for their firms which are difficult to replace in short term period and audit firms consider knowledge and competences of these key management members difficult to copy being tacit knowledge, as explained by Alvesson (2004) in literature, and distinctive competence of service providers firms lies in the skills of the employees which was supported by Pfeffer (1994).

Technology is already there which seem to be sufficient to meet the clients’ needs whereas employees’ awareness and understanding about the clients’ business needs is more vital for developing new services and responding the market quickly. Customers of SMPs look quite satisfied with SMPs as SMPs are managing to generate new services in the market without any pressure from customers for latest technologies. This show that human capital makes the customers satisfied through their services by utilizing required existing technological tools efficiently and effectively. Investment in technology and R&D is important but not the only one which is sufficient to develop innovation capacity in SMPs in our case. It should be combined with investments in Human Capital as this would make it possible to transform the service innovation potential into competitive and productive realities.

Human capital is considered as the most crucial factor in SMPs to determine and ensure firm's competitiveness given that employees' knowledge, expertise, competencies, creativity, and problems solving capacity are considered resources needed to fulfill the demands of uncertain and turbulent environment and accomplish firm's objectives. Our empirical data show that employees in SMPs and especially partners and senior management have more entrepreneur spirit toward new services and willingness for long life learning approach to remain updated resulting new services, these two important personal attributes of human capital are also included by Carson et al., (2004) in the literature.

Our empirical data show that employees in SMPs have good relations with most of their clients and clients consider auditors as their priority to get advisory services. This is possible due to strong relationship of SMPs' with clients and trust in their relationship make the clients feel more comfortable to discuss their consultancy and advisory needs with auditors. Through networking and good relationship developed by SMPs employees, new customers are also referred to audit firms for solutions of their business problems and human capital exploits relational capital efficiently for getting new services from the market. Our empirical data show that SMPs' relationship with the customers and satisfactory services in this relationship become main marketing tool to attract new customers in the market. This indicates that interpersonal skills of the human resources in SMPs are more important in the relationship with the less educated clients. Networking and referrals created by human resources help SMPs to get new services from the market, this coincides with Sarapaivanich & Patterson (2014) and Fontaine et al. (2013) as they perceive that value does not appear to be affected by clients' views on the technical quality of the audit report. The strongest value driver, on the other hand, is the quality of the interpersonal contact. Strong relationship is considered as positive by both parties as customers feel free to discuss irregularities with the intention for guidance and auditors understands the clients' challenges and business technicalities in more detail. This coincides with literature where researchers (e.g Boone et al. 2000; Lawrence et al., 2011) as they explain that small firms are in better position to have good relations with small clients.

SMPs in Pakistan are willing to focus on international clients as these customers generate better income to the SMPs, along with local customers, SMPs want to equip themselves well in order to respond such international customers by updating themselves with the client's countries rules and regulations as these customers' demands have created new service

avenues for SMPs. SMPs top management are motivated to understand the clients' needs thoroughly in more detail from idea generation till after-consumption services with the intention to extract more services and improvement in services. This corresponds to the Berry et al. (2006) as he argues that in all markets the firm's understanding of clients' demand helps in delivering a comprehensive customer experience that is relevant for creating service innovation.

SMPs' customers are small businessman, so such clients prefer to approach SMPs instead of big audit firms because SMPs due to close relationship with their clients are in better position to understand clients' businesses. Mostly SMPs are fulfilling all needs of their small customers through one-window operations / services, like they are their external auditors, and they are also providing them tax services and process management services. Nature of services is very well understood through firm's relationship with the clients, and this can increase firm's focus for meeting client's needs.

Close client relationship and trust is developed through SMPs' quality services being provided to the customers as per their requirements. SMPs' business success is dependent upon employees' social networking and retention of loyal customers which is also supported by literature (Gronroos, 1979; Mouzas & Naude, 2007). Cooperation and collaboration with clients are important for the innovation process and SMPs consider importance of social capital to play a vital role in the effectiveness of cooperation and collaboration. This also integrates with the literature as described by Rutten & Boekema (2007) and Shan et al. (1994). Trust is also considered a prerequisite for effective innovation collaboration which is mentioned by Fountain (1998) in literature.

Both employees and clients contribute their role for creating service innovation in co-innovation process in the service industry, but our empirical analysis show that human resources in SMPs are more connected to their clients and they dedicate needed resources and technology to address the innovation required by their clients. This indicates that human capital is a powerful factor in co-innovation process in SMPs than clients' role as SMPs' employees are more able to understand anthropologically and translate clients' business situations and technological needs and then extract ideas for service innovation. These empirical findings are in align with Sundbo et al. (2015) who uses the terminology "Translation" for explaining the employee's role in service industry. SMPs enjoy more customer empathy and open discussion with their clients due to less communication gap

which also help the employees to understand their markets needs more quickly than big audit firms.

5.3 Careful Use of Technology is the Key

Digitalization helps SMPs to create new markets, new customers, and ultimately new services. Online available accounting software and social media help them to reduce the gap between client and auditor. SMPs employees are well aware about existing software available in the market which can be used by their clients for their business solutions. SMPs help their clients to install and use cheap online software and they are also connected to their software online without visiting to their offices physically. This coincides with the literature as Ardley & MacManus (2019) narrates that service innovation has attracted more opportunities due to growth in digitalization, use of extensive social media and digital markets.

Technology helps clients to consider outsourcing more important than before and helps both parties in interaction. Some clients have outsourced their accounts and finance department to the audit firm which is possible owing to technological advancement. Many firms from developed countries are making their back offices with the partnership of local audit firms in Pakistan due to utilization of existing technological tools and cheap labor available in the country. SMPs are focusing more on international business, outsourcing services and such kinds of online services have become more common in SMPs due to good source of revenue generation. This coincides with what describe by the literature (IAASB, 2016; Alles, 2015; Ghasemi et al., 2011), that customers who use advanced technology in their business can have expectations that the auditor also utilizes the same technology effectively.

Based on our empirical data, SMPs are lacking in core technology to be used for performing audits of the clients and SMPs are reluctant in embracing latest technology in their audit working. Most of the audit firms are only using technology to maintain documentation without any involvement of technology in the performance of the audits and execution of audit is still manual in the audit industry. This indicates that SMPs are not using latest technological solutions while conducting external audits. In fact, auditing is still a manual process in SMPs, and these audit firms have not adopted computerized auditing tools and techniques. Our empirical data indicate that SMPs in Pakistan are not using any audit software during external audits, and this coincides with findings of Ahmi and Kent (2013) who conduct the research on SMPs in a developed economy and conclude that less evidence is witnessed about adoption of computer assisted audit tools and techniques (CAATTs) by small and medium audit firms in UK.

SMPs perceive the utility of advance audit tools and software very limited when compared to investment involved in the procurement of audit software. SMPs do not want to involve in such capital expenditure through procurement of audit software as they perceive it less effective for them to utilize during their audit procedures. Different reasons by different SMPs for not using audit software are analyzed by the authors of the thesis. Main reason is considered a smaller number of small audit clients are being handled by SMPs and these small clients have simple operations without much complication, so auditors do not feel any pressure to utilize audit software during audits of such small clients. These few small audit clients are not a main source of revenue generation for SMPs, so auditors do not feel any attraction to adopt computer assisted audit tools. SMPs take this investment in the audit software like a gamble, and they are unsure about reaps of the investment. Our empirical data reinforce that SMPs are not willing to use latest software and technologies in audit tasks and prefer to utilize existing technologies. We are of the opinion that if audit software would add value in SMP's working, they will definitely adopt such audit software to use during their audit procedures. If they would not utilize the audit software efficiently to meet its required utility and benefits during audits, this does not seem rational to buy audit software.

SMPs also highlight cheap labor factor as an important factor for not considering audit software much important for them. SMPs have sufficient available cheap labor staff for their different assignments and these staff can perform their working on excel sheets. Audit firms did not think CA (Chartered Accountant) trainees and other staff so expensive that they should be replaced by the latest technologies. Audit software helps to smooth the audit procedures and reduce the human involvement as compared to manual auditing and can substantially reduce expensive labor cost like in developed countries, so audit software may be a good option for audit firms in the developed economies. Authors of this master thesis could not find any relevant literature where such factor was discussed in literatures as an important factor as a barrier to procure new technology and software in developing and emerging economies. Another reason is that SMPs do not want to be dependent on audit software vendor and want to avoid any hassle of subscription, update, and maintenance software charges. Further, SMPs are comfortable with traditional methods of external auditing and do not want to learn new software as most of the partners in the firms are seniors and have much previous experience in manual auditing to produce the same result. Audit software update requires training of all staff, so they are not comfortable with such requirements. This is also supported by the literature that auditors need training to use audit software (Singleton,

2006) along-with time and financial cost involved in it (Ahmi and Kent, 2013). Technical problems in handling clients' data are already highlighted in the literature (Braun and Davis, 2003; Ahmi and Kent, 2013; Waldon (2018) such as, often auditors may face problems in making the data for initial usage, so this needs some arrangement for auditor to understand the client's data type before use of data in audit software.

Even though the usage of audit software and other sophisticated IT tools is limited in SMPs, but still digitalization facilitates in development of new services in SMPs. Our empirical data indicates that SMPs are more interested to utilize existing technology optimally instead of adoption of new and incompatible technology because competent auditors drive the SMPs market, not the technology. SMPs employees understand real need of customers and utilize necessary technology to respond the market. This is supported by the literature as Damanpour (2009) explains that innovation facilitates necessary adaptive changes to the environment and innovations in service firms primarily do not follow and go after technological imperative. Our empirical data indicates that audit firms are comfortable using existing IT tools and these existing tools are enough for them to produce the value and output in efficient and effective way. SMPs are balancing quite well the pressure for utilization of required technology by keeping their clients satisfied and retained, as well as creating required employees' skills and expertise to respond to their clients' needs. Through strong relationship and translation techniques in social relation with their clients and among employees themselves also, SMPs are in better position to understand true needs for new ideas and services in the market. This also coincides with literature where Vossen & Van Gestel (2019) uses the translation studies in the adoption of new ideas through social interactions and highlights the crucial role of interpersonal relationships for outcomes. On one hand, technology helps auditor to perform their task whereas on the other hand through service innovation, auditors and clients may close to each other due to more social interactions and relationship which may weaken the auditor's independence. So, in this case, professional auditor should balance his role as an auditor as well as consultant to produce new services in coordination with the clients. Otherwise, there may be chance that while creating new services, auditor may impair his independence as an auditor, especially in SMPs and clients' financials issued by auditor may be less credible. These are the risks associated with service innovation by external auditors.

In last couple of years ICAP show its intention to help SMPs by contracting with vendor to provide cheap audit software to SMPs but still ICAP could not execute its own plan. SMPs

are not keen to get audit software as it looks that they are fully satisfied with the utilization of existing technological tools in auditing practices. Even some SMPs management never heard about audit software and its lucrative features so they never think about new technological solutions for their firms. Purchase of audit software is strategic decision and staff members at strategic level do not see it effective and pragmatic decision to procure audit software, because existing auditor practices in SMPs are well compatible with existing technologies and these prevailing technologies are enough to support the auditors working. Our empirical data signifies that SMPs will not gain a significant competitive advantage from being proactive in adopting new software / technology and later they will convince their customers and market to change digitally as per latest technology.

SMPs are using MS Excel (MS Office) efficiently to get maximum benefits during different audit tasks and other services. Although SMPs highlight some critical consequences of utilization of simple IT solutions in audit firms such as audit quality and independence but still they consider MS Excel is the best option to use currently when their clients are small with uncomplicated business process. Most of their audit program and other working for new services are performed in MS Excel and auditors use this software to make analytics. Auditors excellent grip on this spread sheet software help them to examine and determine the validity clients' financial information and to confirm that clients' financials does not contain significant misinformation. MS Excel is enough for auditors in SMPs to produce the same output result (final financial statements) as auditors produce in big audit firms through automated audit software. This indicates that available technology is helping the auditors in SMPs to perform their real work as auditor without compromise over audit quality which coincides with literature (Gulden, 2015; Varci, 2013; IAASB, 2016) where main role of auditor is defined to confirm the company's financials with reasonable assurance.

Further, SMPs also perceive this spread sheet software more than enough for their working for different assignments in addition of external audit. SMPs are using less advanced technology but they are utilizing this available technology in its entirety (almost 100%). Human capital involved in the SMPs is competent enough to utilize the existing technology exceptionally well that nothing remains un-used in it. This integrates with what describe by Alles (2015), as auditing companies will try to adapt to customer practices and are often reluctant to use technology that is far ahead of those adopted by their clients (Alles, 2015).

SMPs are not rushing to adopt the advanced audit software or tools and they want to adapt technology according to their clients. But at the same time, they are developing new services and extending their market because of digitalization. SMPs look satisfied with the current use of technological advancement and digitalization to meet the customer's demands. Technology helps them to explore new markets as there is no business boundary exists for SMPs and they have access to the whole world. SMPs now prefer to capture maximum international customers as existing technology helps them to find new clients internationally. At one side SMPs are thinking themselves as conservative and reactive in adopting new core audit tools and on the other side they are not only exploring the new services and opportunities in the domestic market but also creating new services in the international market due to utilization of prevailing technology quite well. This indicates that SMPs are using technology very carefully and smartly as they are exploiting the digitalization and technological tools as per market's needs.

6.0 Conclusion

In this thesis, we have studied more closely at the phenomenon of service innovation in the auditing industry in Pakistan. Technology-based service innovations which are, as a rule, resource-intensive and therefore is mainly available to big 4 audit firms, and audit firms and clients in a developed country are more technological advanced and get the benefits from digitalization to create service innovation. Our motivation was to study how service innovation can still be organized in small and medium sized audit firms in a developing country as if firms and clients are not adoptive to latest technologies, then how small audit firms create service innovation in the market, and what factors contribute to this service innovation process.

Our findings show that SMPs are more interested in service innovation than external audit services because innovative services are perceived a main source for their survival and existence in the market. Service innovation is like blood for SMPs and if these audit firms cannot create new services from the market, they may attract their demise. SMPs generate service innovation to succeed by meeting customers' demands through efficient utilization of employees' skills, knowledge and expertise.

The other important findings indicate that human capital is more powerful factor for SMPs than technology. They think that technology only assist them to handle different services, but new service ideas and new projects are being initiated by the competent people. Human capital is in better position to decide which technological tools are more effective for the firms to implement during their business processes and operations to create service innovation. Partners and employees of small and medium audit firms are closer to their clients due to their strong relationship, and they exploit relational capital quite well to understand the technological and other business needs of the clients.

Auditors in SMPs have exceptional command in easily available MS Excel software that they are performing audit programs and many kinds of analytics in this software and their competencies and skills to utilize the software make the potential difference. It might be the case that being technological proactive in adopting advanced digitalization can be challenging and may not necessarily be the best option for SMPs to treat their customers. Instead, we conclude, SMPs could consider utilizing the existing technology exceptionally well and fulfilling the needs of the customers satisfactorily with available technology without rushing for latest technology. SMPs are focusing more on international business and outsourcing

services owing to optimal utilization of digitalization. Service innovation facilitates necessary adaptive changes to the environment and innovations in audit firms primarily do not follow and go after technological imperative. Thus, whatever SMPs consider service innovation via digitalization – on local market or internationally, the importance of careful digitalization in audit industry should not be overlooked.

6.1 Limitation and Further Research

There are always some issues, limitations and demarcations that can occur during the research. The service innovation in SMPs is a relatively new topic. Thus, there is a scarcity of previous literature, which on one hand gives the researcher liberty for innovative thinking and on other hand it also causes challenges for the research. Our focus was auditor and not the customer because of mode of research and limited time, which limits our view, and we cannot see the wider picture of the situation regarding service innovation. We believe that a holistic understanding of service innovation in small and medium-sized auditing firms cannot be achieved by studying the firms separately from their clients. We therefore believe that there is a need for a deeper understanding of what is customers' perspective regarding service innovation in SMPs. It could also have been very interesting to conduct a comparative study, with the aim to examine and identify differences and similarities in customers and auditor's perspective.

As our research focused on one geographical area – Pakistan, therefore provided information may not be valid for other regions or markets and cannot be globally generalized. In total ten people from different SMPs were interviewed for this research. Even though the gathered data is quite comprehensive yet researches in the future could increase the number of interviewees who have more knowledge, insights, and experience with SMPs. Moreover, our study is limited to the facilitators of service innovation in SMPs, but barriers of service innovation can also be considered for future research. The impact of service innovation on the performance of firms as well as on the independence of the auditors in SMPs can also be studied in detail. Further, research on service innovation in SMPs can be expanded by examining other economies and approaching more firms' officials from different geographical areas.

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Appendix-1

List showing details about the informants and their audit firms

Short Name	Audit Firm Type	Designation	Experience In Years	Partner(s)	Staff	Customers
A	QCR	Manager	8	7	45	35
B	QCR	Senior Manager	10	3	32	63
C	Non-QCR	Partner	8	1	7	12
D	QCR	Manager	6	7	25	62
E	Non-QCR	Partner	12	2	12	35
F	QCR	Partner	11	3	16	55
G	Non-QCR	Partner	7	2	15	37
H	QCR	Manager	8	3	22	48
I	Non-QCR	Manager	9	4	13	35
J	QCR	Partner	15	3	35	68

Interview Guide

Part 1: Introduction

1. Background of the informants, Education & Experience. What is your role in the audit firm?
2. What kind of accounting and auditing services your firm provide to clients? How services are changing in the auditing industry?

Part 2: Reflection on Service Innovation

3. Does your firm create new services and / or improve existing services on frequent basis? How much service innovation is important for your audit firm?
4. Can you talk about a new service or a significantly improved service introduced by your firm during last three years?
5. How new services are created and developed by your audit firm?

Part 3: Facilitating factors for Service innovation

- What are the main internal and external facilitators / factors for creating service innovation in your audit firms?
- What is the role of employees / human capital for creating service innovation in your firm? How staff remains updated themselves to fulfil the new needs / services of clients? Does top management support and encourage new services / ideas by employees?
- Can you tell us about the relationship with your customers? How client-auditor relationship effects service innovation in your audit firm?
- How customers' needs help your audit firm to create service innovation?
- What is the role of digitalization and technology in your audit firm for creating service innovation? How you see the technological changes impacting the services in the near future?
- Any other important area you want to discuss regarding service innovation in your audit firm and overall in small and medium sized audit firms industry?