

Tacit Knowledge, Audit Quality, and Talent Identification

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Abstract: Organizations are keen on identifying and understanding sources of competitive advantage. For human-capital intensive companies, their largest asset and hence a source of competitive advantage is typically their employees who possess a unique set of skills which is valuable to the creation of products or services. In this study, we investigate to what extent tacit knowledge serves as valuable input to the creation of services. Furthermore, if tacit knowledge is found to be a value-enhancing factor, arguably it should be incorporated into the employee's performance and potential assessment. We examine our questions in the context of the auditing industry where audit quality represents the service based on which companies can differentiate themselves. Using survey measures and unique proprietary data of a Big 4 firm, we find evidence that the audit leaders' level of tacit knowledge explains variation in audit quality as defined by the firm's internal assessment of audit quality. Given its value-creating character, we subsequently examine whether tacit knowledge is a criterion that is incorporated in the talent identification process. We find that tacit knowledge is largely ignored or even negatively correlated with the firm's assessment of potential, which likely provides an explanation for the loss of talent in professional audit firms.