

SHAKEN BY THE ROOTS

**WHY PROFESSIONAL
SERVICES MUST EVOLVE**



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Executive summary

The professional services industry has a long and illustrious history. The roots of today's legal profession lie in ancient Athens, where "orators" would write speeches for the accused to read out at their trials.¹ The accounting profession goes back even further: scribes in the warehouses of ancient Sumer developed cuneiform, the world's first written language, in order to manage their stock. Even advertising agencies, which like to cast themselves as creatures of "the now", have a surprisingly long history: the first such firm, William Taylor, was launched in London in 1786. And the first management consultancy, Arthur D Little, was founded in 1886 in Boston, Massachusetts.

In the 19th and 20th centuries technology radically reshaped those industries that relied on physical labour, such as manufacturing and agriculture. Professional services firms, whose business was driven by intellect, education, experience and relationships, were left relatively untouched.

That is no longer the case. In recent times the professional services sector has found itself at the nexus of a number of era-defining forces that have shaken the foundations of its long-established business model.

This report from The Economist Intelligence Unit, sponsored by Deltek, examines the forces that are reshaping the sector and assesses their current and future impact. It also identifies, with reference to real-world examples, how professional services firms must adapt in response to these trends.

The key findings are as follows:

- **Global forces, driven in large part by technology, are reshaping the market dynamics in the professional services sector.** Globalisation, market liberalisation and the Internet have dramatically increased the potential reach of professional services firms dramatically, but they have also exposed firms that might once have dominated a local market to intense competition from firms all around the world. They have also led to

the commoditisation of much of the work that professional services firms do—a trend that will only continue as the sophistication of automation increases. Each of these trends challenges firms to extend their reach, either geographically in terms of specialisation or through their use of technology.

- **One response to these forces is to build a global scale.** The giants of the sector—most notably the Big Four accounting firms—have for a long time operated on a global scale. As a result, the forces of globalisation and hyperconnectivity have been mostly beneficial for them. They are more troubling for medium-sized firms, on whose patch these giants are increasingly encroaching. All segments within the sector have therefore seen considerable consolidation as medium-sized firms try to build a global stature. Many of those who failed to do so have withered, with well-established names such as Booz & Company absorbed into bigger rivals.
- **Professional services firms are also expanding their areas of specialisation.** Enabled in part by market liberalisation in certain geographies, professional services firms are looking to expand their areas of expertise. This includes firms tracking market trends closely to ensure that their service offerings follow client demand and adjusting their skills base accordingly, or expanding into related service offerings, as exemplified by the accountancy giants building legal practices and management consultants starting up digital practices to compete with traditional advertising and marketing firms. This trend is driving firms to foster new partnerships and new approaches to sourcing expertise.
- **Effective use of technology is helping firms to compete on a global level.** Not every firm aspires to spread itself across the globe and into every field of specialisation—there is still a role for niche providers with depth of expertise in a particular field. Technological innovation will be an increasingly important capability for these firms, as it will allow them to apply their expertise in

¹ https://www.jstor.org/stable/1065786?seq=1#page_scan_tab_contents

new, more scalable ways than the current, billable-hours business model that most firms follow. They may have to think laterally, however, to access that innovation.

- **To weather the current upheaval, firms must be absolutely clear what value they offer clients.** Thanks to the availability of information on the Internet and the trend of companies to build professional expertise in-house, clients

are increasingly aware of the range of professional service offerings they have available to them. The gradual and ongoing shift towards outcome-based pricing will force firms to identify and prioritise the resources that deliver the greatest customer value and find ways to discharge what is left. This will be a painful transition, but it will be the making of many firms.

About this research

Shaken to the roots: How and why professional services must evolve is a report written by The Economist Intelligence Unit (EIU) and sponsored by Deltek.

The EIU would like to thank the following interviewees for their time and insight (listed alphabetically):

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- **Ken Cable**,
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- **Richard Susskind**,
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Introduction

The forces driving change

Back in 2010 some 52,000 students were enrolled in US law schools. By 2014 that number had crumbled to 38,000. And of those, only two-thirds (60%) had found a proper job in the legal profession a year after graduation, according to the American Bar Association.

Similar declines in recruitment have been seen across the professional services sector, although this needs to be placed in context: the overall US legal market continues to grow, according to research by Citi Private Bank's Law Firm Group, as does the global management consultancy market, according to Boston Consulting Group. However, across professional services business is increasingly polarised between big firms with the scale to offer a full range of services to global clients and smaller niche firms with a specialism in a particular field. The middle has been eroded, leading to many well-established (but not giant) firms collapsing or being taken over, from the likes of Halcrow in architecture to Monitor in consulting. Such perceived fragility deters graduates from entering the professions. This concentration is due in part to the recent financial downturn, but it also reflects a confluence of interconnected trends that are challenging the long-established value proposition of professional services firms.

Futurist Ross Dawson identifies seven trends that are transforming the sector. The first is the growing sophistication of clients. This has resulted from both the growing availability of information and expertise online and the trend towards businesses hiring professional expertise internally, such as in-house legal counsel.

Next are market liberalisation and globalisation, both of which have exposed firms that once dominated their local market to competition from, or acquisition by, foreign rivals. The next three—connectivity, transparency and the modularisation of professional work—all contribute to the final driver: commoditisation. In every market low-cost, high-volume providers are gradually encroaching on the service offerings of more traditional firms.

Technology is the driving force behind many of these trends. The Internet has transformed the dynamics of the professional services sector by removing the distance between clients and their advisers.

And technology will continue to drive upheaval in the industry in future. Compared with businesses that rely on physical labour, professional services firms have to date been relatively immune from automation. That is changing, as advances in artificial intelligence allow increasingly complex cognitive tasks to be performed by computers.

Richard Susskind, an academic and legal consultant who recently co-authored a book about the future of professional services, offers two alternative scenarios: first, a relatively benign one, where technology simply allows professionals to do much of the same work more efficiently, such as media agencies using technology to buy advertising more effectively—still a core activity for them, but one which no longer requires a large amount of staff time. And second, one where advances in fields such as artificial intelligence allow technology to take over a large part of existing markets.

That would fundamentally change the role of professionals traditionally employed to give expert, face-to-face advice on matters that are now being automated. There are already examples of this happening, such as tax returns being filed online or people drawing up their own wills. The need for expert, face-to-face advice has gone, begging the question of what the professional's role is now.

The precise implications of these trends vary by market and specialisation. But there are, broadly speaking, two ways in which professional services firms can adapt. The first is to increase their size and scope to match the scale of the addressable market they can now reach. The second is to narrow their focus on what makes them unique. These strategies are not necessarily mutually exclusive, however, and some firms are seeking to achieve both.

1. Achieving global scale

When it comes to operating globally, some professional services companies are better than others. "The Big Four accountants are in the lead here," says David Fubini at Harvard Business School.

Andy Baldwin, area managing partner for Europe, the Middle East, India and Africa at the Big Four stalwart EY, explains that the firm is split up into various regions and subregions to ensure the vital mix of globalisation and local input, with a global management followed by four big regions, including his own and 28 subregions, such as the UK and Ireland. It is a refined but well-established model on which the big consultancies have long based their global reach.

In other segments of the industry, larger players are still evolving their operating models to meet the demands of a truly globalised business. To achieve global scale, French advertising giant Publicis Groupe acquired a plethora of smaller agencies with various specialisations around the world. At first Publicis acted as an umbrella organisation to these individual outfits, but it has recently restructured to become a one-stop shop giving clients access to specialist expertise wherever they may be (see case study). "The need to offer a localised, global service and span all platforms means a change of company structure," says strategy boss Richard Hartell.

Pascal Cotte is chairman for Western Europe, South America and Northern Africa at management consultancy Boston Consulting Group. Globalisation and the growing complexity of international commerce have been good news for management consultants, he says, "as companies seek advice on complex globalisation issues, mainly on how to be able to react quickly to change".

But not all firms have the capacity to achieve the necessary scale, and not all can survive. "The market is becoming split between specialised boutiques, which can disappear overnight if their niche goes, and big firms," says Mr Cotte. "The middle has been squeezed, and firms have disappeared or been bought."

For many firms, this has led to consolidation. Mr Cotte cites Booz & Company, a consultancy that was split up in 2014, with one part bought by PwC, and Monitor, a well-established strategy consultancy that was bought by Deloitte in 2012. The same has been seen in public relations and advertising, and there have been record numbers of mergers in the legal sector as smaller firms struggle to compete on their own: in the US, some 91 mergers were announced in 2015, according to consulting firm Altman Weil, the highest number since it began tracking the market in 2007. There were more than 2,000 merger and acquisition deals in the engineering and construction sector in 2015, according to PwC, as companies expanded their international reach through acquisition and the two sectors increasingly recognised the need to merge their specialisms to offer clients a global, integrated service.

Philadelphia-based Morgan Lewis is one example of a law firm pursuing "global breadth" through mergers and acquisitions. In 2014 it hired the majority of partners from a well-established Boston firm, Bingham McCutchen, after it went out of business. This deepened the firm's presence in some key national markets, including New York and Washington, DC. Then, in March 2015, it merged with a Singaporean firm, Stamford, to create the first fully integrated law firm in the city state. This gave it a sizeable foothold in a key region for many of its multinational clients.

Case study: Publicis Groupe

How an advertising giant turned itself “upside down” to satisfy global clients

It used to be so simple. Back in the 1980s media buyers could choose from a few print publications with closely defined readerships on behalf of their advertisers, and they knew that a well-placed television ad would reach 80% of the population. Today, clients expect their marketing efforts to have a global reach and to encompass everything from the old-fashioned TV and print ads to the social media campaigns and “influencer relations”.

At the start of 2016, in response to these growing demands, French marketing services giant Publicis Groupe launched a thoroughgoing organisational restructuring. Until then it had operated as an umbrella organisation for a series of well-known brands in areas such as marketing and public relations, including Saatchi & Saatchi and Leo Burnett. In order to make itself more customer-focused, the company announced that it would be turning its structure “upside down” and reorganise itself into four units: communications; media; digital and consulting; and healthcare. Its advertisers would no longer find themselves dealing with a particular brand, such as Saatchi; instead, advertisers would deal with a single face in the form of one of its newly created “chief client officers” to access all of the group’s services.

Richard Hartell, Publicis Groupe’s global president of strategy and transformation, explains that the business needed to change because of the “three big trends hitting our clients, and therefore us”. First, there is globalisation, which means that many clients expect their marketing campaigns

to reach a global audience. Then there is the “digitally connected world, with a multitude of media that people expect our clients to cover”. And third, there is the new transparency offered by the Internet, in particular. This “creates a new type of interdependency”, according to Mr Hartell; there is complete transparency where company scandals and product quality are concerned, but equally it means that marketing can be tailored much more exactly as data analysis offers a more exact picture of customers.

Given these shifts, the company was forced to make some basic changes. Media buying is now largely automated, for example, whereas it used to take up the bulk of staff time—computers offer better results at a much lower cost than people these days. Equally, the skills required have changed with the business, leading to some shortages. Some 50% of staff now spend all of their working time on digital work, compared with less than 10% a decade ago, and the other 50% spend at least some of their time on digital. This means that the hiring of data analysts and similar specialists has accelerated over the past 2-3 years, resulting in higher wages and some shortages.

So the firm made some fundamental changes on the grounds that this is what shifting customer demand required. But it also felt that in order for the value of these changes to be more visible to the customer, it needed to move to a more unified and global operating model.

2. Expanding specialisation

Another way in which professional services firms can expand their reach in the face of the globalisation of their industry is to broaden their specialisation.

Boston Consulting manages its resources according to a matrix system, first launched 20 years ago, that integrates sectoral expertise, such as manufacturing or banking, with operational expertise in, for example, technology and markets. This allows the firm to see which capabilities it needs to build on. "We use a grid system to see which areas are growing and invest in them," Mr Cotte says.

Today, that means building up expertise in areas such as cybersecurity and data analytics. For this, the company often looks beyond the professional services sector. It has, for example, recently hired some former managers from Japanese carmaker Toyota, who advise its manufacturing clients on operational efficiency.

This broadening of specialisations has been aided by the liberalisation of various markets. One obvious example is the expansion of the Big Four accountancy firms into law, with PwC employing more than 2,000 lawyers. In some countries the big consultancies are now among the biggest law firms, despite their history in accountancy.

Medium-sized firms, too, are starting to diversify into new areas, often building on their core expertise and clients. Take Mishcon de Reya, a medium-sized law firm in London known for its litigation work. Last year it adopted an alternative business structure allowing external capital in and freeing it to enter sectors beyond the law.

This has enabled the firm to build on its traditional base of wealthy, sometimes entrepreneurial clients to launch a number of subsidiary companies that operate outside the conventional law firm model. Mishcon Discover is an e-disclosure company, using cognitive recognition software to search for information required in court cases. "It's a service for existing clients, but we can also do work for small law firms lacking the resources for this," explains chief strategy officer Nick West. Mayfair Private offers family office services for existing clients and other wealthy individuals. More launches are planned as Mishcon expands into new areas related to its core business.

For EY, meanwhile, the direction of its expanding specialisation is towards the digitisation of business. "Digital has been a heavy focus of our partner hiring and investment over the past 2-3 years, and we've spent US\$500m on this and on acquiring digital companies," explains Mr Baldwin.

He adds that the firm will perhaps start to train its own data specialists, building up in-house expertise in the same way as it has traditionally done for accountancy and other areas. This kind of expertise will be in especially high demand among professional services firms as data analytics increasingly underpins not only the services they offer to clients, but also their assessment of their own performance, strategic direction and market positioning.

EY is also increasing the number of alliances and with what Mr Baldwin calls "outside capabilities", such as GE Digital. Some of the other Big Four firms have set up freelance management sites so that they can access a global pool of specialists in a wide variety of areas as and when required.

3. Automating services

Some firms are reacting to the globalisation of the professional services industry by becoming all things to all men. It is widely acknowledged that there will always be room for specialist or boutique firms that do one thing exceptionally well. However, if these firms stick to their traditional service offerings and business practices, they will be at risk of disruption by automated systems.

In fact, technology has already replaced or surpassed many professional areas—or is threatening to do so soon. In architecture, virtual design tools from firms such as Autodesk are already heavily used by professionals and allow a single person to design buildings that would previously have required a large team. Audit firms are abandoning manual sampling, in which a professional auditor looks at a subset of a client's accounts in the hope that they are representative of the whole, in favour of real-time automated sampling of their entire accounts. Legal surveys are cheaper and more accurate using data analysis technology than using paralegals or junior lawyers, according to Professor Susskind. "Professionals are practical experts offering face-to-face advice," he adds. "Now technology is taking on many tasks that used to be the exclusive work of these professionals."

With technology taking over so many tasks, what work will be left for the professionals? In fact, Professor Susskind does not argue that increasing automation will wipe out professional services firms, but he does say that it will change the nature of their work. Rather than relying on a single informed professional or a team of professionals, work will be divided into several separate parts, some of which can be automated and some of which will still require skilled professionals. This, says Gabriel Teninbaum at Suffolk Law School in Boston, Massachusetts, will help to grow professional services markets by making work cheaper, and therefore available to more clients. "So a bigger volume of work at lower costs protects legal jobs," he says, pointing out that much of the work being automated is being done by lower-skilled professionals, such

as paralegals. "This actually creates more work for lawyers, whose role becomes one of review and advice, not of form filling."

So far, the opportunities presented by automation have been most visibly captured by digital companies such as TurboTax, which guides people through filing their own tax returns online, and LegalZoom, which uses a guided interview so that people can draw up their own wills. Small and medium-sized firms might feel that this kind of technological innovation is reserved for start-ups and global mega firms, but examples such as US accountancy firm Crowe Howarth (see case study) show that this need not be the case. Indeed, the effective use of technology can be a way for firms to preserve their independence and individual identity.

Of course, new technology comes at a cost, and small firms may need to think laterally to access it. When David Kohn won his first major new build project in 2015 for New College, University of Oxford, he knew he would need access to business information modelling (BIM) software, which allows architects and their consultant teams to construct a 3D model of a building that coordinates all its many parameters and functional characteristics. "We had to find £80,000 for BIM," he says. The firm therefore partnered with the client in order to access the software in its early stage. It was a decision that paid off: BIM is now mandatory for all building designs in the UK.

Another driver for automation in the professional services sector is the shift towards outcome-based fees. Rather than billing on the basis of a professional's time, clients are increasingly demanding that they pay according to the results that are achieved. This is still a minority practice—EY's Mr Baldwin says that, as a proportion of the firm's business, outcome-based fees are still "in single digits but growing fast". But as it grows, it will put even greater pressure on firms to ensure that the expertise of their employees is applied in ways that create the greatest value for clients. Anything that can be automated, therefore will be.

Case study: Crowe Horwath

How a medium-sized US accountancy firm created a global presence through technology

The forces reshaping the professional services sector have been especially cruel to medium-sized firms, and many have succumbed to consolidation. So one might expect US accounting firm Crowe Horwath to be struggling: it is just the eighth-largest accounting firm in the country, with revenue one-tenth the size of that of the smallest of the Big Four, KPMG. It should, in short, be the sort of medium-sized firm being squeezed by its inability to compete for lucrative global work, or low-margin local work.

In fact, it has thrived by using technology and concentrating on some very specific sectors to compete with the global giants. "We found we didn't succeed as generalists," says its chief strategy and innovation officer, Derek Bang. "So we have a very strong concentration on some specific sectors."

In audit work, the firm has over the last five years carved itself a niche among large regional and medium-sized national banks, as well as in fast-growing areas such as technology firms and some specialist areas of the energy market. In consultancy work, however, the firm competes head-on with the major global firms, and with some success.

In contrast to the Big Four, which generally emphasise the need for global integration, Crowe Horwath International remains a federation of some 209 local firms. Spread across 130 different countries, the firm claims that their combined revenue of US\$3.5bn makes this the ninth-largest such network in the world. Nevertheless, it remains a minnow in global terms. How, then, can the firm compete against consultancies ten times its size for consultancy work requiring a global approach, as well as the specialist knowledge garnered in its target sectors?

"The Big Four say 'we have offices and staff around the world'," states Mr Bang. "Though we have a global footprint with some offices and personnel, we also say we can use technology to enhance our global presence." Technology development has been a core focus for the firm since the 1980s. Today it devotes a set proportion of its annual revenue to

technological development, not least to plug the gap for staff whose performance was traditionally measured in terms of billable hours. "We had to avoid penalising them for billing less while they worked on new ideas."

As a result, the firm has come up with a series of technical innovations in its target sectors. In banking, for example, it launched Crowe Caliber, a system that helps financial institutions to model and manage risk and satisfy increasingly stringent regulation. In healthcare, another of its major sectors, Crowe Outpatient Charge Capture Analytics helps medical institutions to monitor and realise outpatient income more quickly.

One especially lucrative development, says Mr Bang, is a tool allowing not-for-profit organisations to file their tax returns more efficiently. Around a decade ago the US government cracked down on not-for-profits that were avoiding tax while paying managers fat salaries. As a result, the tax forms they were required to fill in leapt from eight to more than 80 pages—and compliance departments struggled to do this. Crowe's software allows portions of the forms to be filled in automatically, saving time and money compared with hiring an accountant to piece together all of the necessary data from internal teams. The firm now enjoys a very strong position in the sector.

"We use technology to differentiate ourselves," says Mr Bang. And Crowe Horwath shows that you do not need to be massive to compete.

Conclusion

For a long time the billable hour used to be the core unit of value on which professional services firms built their business. But like so many other facets of the industry, it is in line for disruption. Growing competition within the sector has put clients in a position where they can place more demands on their service providers, and many are using that power to ensure that the fees they pay are more directly linked to the beneficial outcomes they seek.

Although it is still in its infancy and will not necessarily replace all time-based billing, outcome-based pricing will eventually force firms to identify precisely their value proposition to clients. When billing by the hour, firms may not be motivated to ensure that every piece of work they undertake delivers against the objectives of their clients. Under the outcome-based model, any work that does not create value for the client becomes a cost that undermines the firm's profitability.

This is not a negative development, with professional services firms increasingly working in partnership with clients to improve their results, rather than simply charging for the amount of work they do. However, it does carry risks. Outcome-based pricing shifts the operating risk to the seller, so it will be the outside professionals who take the hit if business does not pan out as expected. Improvements in areas such as artificial intelligence make it increasingly possible to predict consumer behaviour, and therefore likely market developments. But if professional services firms get their sums wrong, for example because an unexpected recession hurts their clients' results, then they will suffer from the impact of the downturn far more directly than they would have done under the traditional pay-by-the-hour model.

There are measures that firms can take to mitigate these risks, although some will require a major change of corporate culture and practice. Rather than acting as outside advisers, professionals will need to form close partnerships with clients, establishing a deep level of trust to work with them rather than simply for them. That, in turn, will

allow them to understand their clients' markets sufficiently to set the very concrete targets and outcomes required under the payment terms—and to agree on an informed sharing of the risks and rewards of a project. They will also need to spend heavily on technology to gather and analyse the data necessary to predict market movements and business outcomes. This can all be done—and is being done—in some sectors such as management consultancy. But it is also a big change of approach for firms in sectors such as architecture and law.

Adopting such an approach will also allow firms to exploit the new technologies becoming available, rather than being wiped out by them. Globalisation has already brought some big changes to the professional services market, with firms needing to grow big enough to offer global clients the breadth and depth of the expertise now required—or at least forging a specialist niche where they can compete on knowledge. Increasingly, they will need to change their role and their thinking about themselves to keep pace with the changes wrought by technology.

Firms from sectors as diverse as media and accountancy already talk of themselves as being technology or digital companies, combining their traditional skills with a deep grasp of data analysis and "the new media". In law, Professor Susskind talks of new roles emerging at the intersection of law and software—he mentions "legal knowledge engineer" and "process analyst", among others. Across professional services, the nature of the work carried out by professionals will change as they combine their specialist knowledge with automated services. For big firms as well as niche players this offers exciting growth potential, with clients relying increasingly on experts to guide them through the complexity of a globalised, connected business world. That is why there is no sign of the professional services market shrinking overall, with people still wanting some human guidance to complement today's increasingly dominant technology.

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