Professional Services Firms: Building a Franchise, Supporting it With Talent

- *Tough market conditions and numerous rude awakenings present professional services firms with an opportunity to take stock with respect to the aggressive growth strategies in which they have been engaged.*
- *We believe that pursuing strategies not built around people has proven to be perilous.*
- *We offer the best and most timely talent management remedies for building and supporting a successful professional services franchise.*

During Spring/Summer 2002, we surveyed several of the largest consulting, accounting and law firms in the country on the challenges of attracting, retaining and keeping talent focused in today's market. Our findings are included in this article.

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INTRODUCTION

Tough market conditions and numerous rude awakenings present professional services firms (PSFs) with an opportunity to take stock with respect to the aggressive growth strategies with which they have been engaged. In virtually every major sector of professional services—law, management consulting, IT consulting, accounting and search—broad global reach has been assumed to be a prerequisite to be a long-term winner. The focal point of PSFs over the past decade has shifted to building bigger and better entities, with a broader reach, better known brand and efficiently-delivered services. Professional services firms have focused on building franchise value in much the same way that their corporate clients do.

Creating Franchise Value	Building a brand image or single recognizable entity, often centered around the company name, key product or leading service. Firms with strong franchise value are able to win business initially and primarily as a result of being associated with a name brand and what it stands for.

We believe that pursuing strategies not built around people has proven to be perilous. For many firms, placing greater emphasis on building franchise value has meant placing lesser value on the individual. As each professional services sector regroups in the wake of the recession and the crisis in corporate governance, firms have the opportunity to re-examine the assumptions that have driven PSF strategy. Our paper discusses the many ways professional services firms are building franchise value, and the best and most timely talent management oriented "remedies" for making it work.

THE MOVE TOWARD BUILDING FRANCHISE VALUE

The recent trend toward building franchise value has taken on several forms: the industry has sought *convergence* opportunities such as merging to achieve scale and breadth, acquiring additional businesses or service lines or through aggressive hiring of individual or pre-existing teams. (And often all of the above!) Among management and IT consultancies, much of this acquisitive and organic growth was achieved though raising capital in the public markets. Technology companies such as IBM have pursued dramatic growth in consulting to diversify beyond products and into services. Concurrent with growth driven by convergence, firms have embraced *branding* as a means of building professional firm franchise value. Finally, firms have sought to turbo-charge their leverage models by placing greater emphasis on *replicable methodology* as a means to create more efficient, predictable and less costly service models.

1. **CONVERGENCE** Similar to the transformation accounting firms underwent in the 80s and 90s, law firms have more recently found ways to build more diverse partnerships, both in terms of geography and service offering through mergers and diversification. Several law firms who have merged often cited the need to grow with and therefore better support the needs of their clientele, or to round out their existing service offering. Arguably the most aggressive is the multi-national merger of New York's Rogers & Wells, Germany's Pünder, Volhard, Weber & Axster and UK-based Clifford Chance, creating a 3,000-lawyer global behemoth with estimated revenue of $1.2 billion its first full year.

   Just as many law firms perceived the major accounting firms as encroaching on their turf, law firms have themselves begun to diversify. Several law firms have built or bought non-legal subsidiaries (and in doing so have added non-legal revenues to the bottom line). Manatt, Phelps & Phillips, LLC, a hundred-partner firm based in Los Angeles, has recently launched a consulting business, "Manatt Jones Global Strategies" which will specialize in helping clients who are looking to enter or improve in a particular foreign market. In the same way, Duane Morris, an AM Law 100 firm based in Philadelphia, has been launching or buying non-legal subsidiaries since 1997. Duane Morris Chairman, Sheldon Bonovitz, notes, "Our goal is to be a professional services organization that renders services in various areas not confined to the practice of law. We're using the accounting firm as a model. Two-thirds of their revenue comes from the outside. Most law firms have less than 1 percent of their revenues from other sources."[1]

2. **Branding** IT consultancies were some of the first professional services firms to build brand through large scale marketing efforts. Before the 1990s a professional services firm would have rarely considered taking out a full size ad in the Journal, let alone plastering airport terminals with their ads. Possibly one of the more memorable efforts is now defunct MarchFIRST's $30 million major media campaign. Launched in June 2000, the campaign, paying tribute to "the human desire to be first and its impact on others", ran all over the place—from the Washington Post to Men's Health magazine; from to NBC's Thursday night "must see TV" to the Sydney Olympics.

   Branding a professional services firm typically involves partners investing current cash flows in activities designed to drive longer-term results. Accounting firms have also been big players in branding. According to Jean Marie Carragher, president of Capstone Marketing[2], branding, which she defines as the "active development of a personal relationship between the client and the product or service," has become the catch phrase for accounting firms. While the branding of the Big5/Final 4 is seen everywhere, the trend to brand is even playing out among smaller regional firms. For example, when two smaller accounting firms in New Jersey–Gikow, Bierman & Talesnick and Herman Yula Schwartz & Lagomarsino–merged in 1999, they decided to select a generic name. In an attempt to differentiate themselves from other accounting firms primarily focused on reporting the past, the Videre Group (from "Videre", the Latin word "to see") was chosen to express the forward looking mind-set of the new entity. Similarly, many law firms are shortening their roll-call style names to just one, such as a firm like Brobeck, Phleger & Harrison, now advertised as just "Brobeck".

3. **Replicable Methodology** Given the process nature of their work, accounting firms have always been drawn toward building value through reliable and repeatable process. The "Big Five" have built a strong name through consistent rather than individualistic approaches. Up until a year ago, it seemed hardly possible for a business to "go wrong" engaging a Big Five accounting firm—the brand name associated with high quality and reliable service was enough. Indeed, much of the Andersen post-mortem activity centers on determining if the firm was the victim of rogue individuals, or if its highly publicized travails were the result of institutional practices, such as tiering pay to the sales of non-audit projects, with terrible unintended consequences.

   In the same way, IT consulting lends itself well to the use of proven practice and methodology. The idea is to apply reusable development tools and solution sets to large scale problems, rather than create unique solutions for specific issues, or "reinventing the proverbial wheel" for every implementation. Firms with replicable methodology have reduced training cost, achieved better

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[1] Source: Bankruptcy Court Decisions' Weekly News and Comment, July 10, 2001.

[2] Source: Macintyre Strater International Limited "Branding – The Catchword of Today's CPA Firms." March 27, 2002.

leverage, created the ability to do larger scale work, and in theory developed better quality control. While clients are rarely prone to crow over having received an off-the-shelf solution, in fact a road-tested implementation capability and track record is a strong selling point today.

WHAT WENT WRONG?

Along with several successes, the professional services sector has experienced several hiccups, some significant failures, scandal and in some cases, a jury that is still out. We've found that regardless of growth strategy, business model, or service offering and in spite of economic market realities, high growth professional firms that fail have one thing in common: lack of regard for where their own talent fits into the firm's franchise building efforts.

1. **CONVERGENCE** The most prominent people failure occurred most recently within the accounting world. Andersen's downfall in part could have been mitigated through improved management of people and pay. Andersen's growth strategy amidst a flattening in audit fees[3] led to the aggressive pursuit of non-audit business from the existing client base. Reported goals of audit partners to sell new, non-audit revenue were tremendous. Cross-selling became the only way to sustain the kind of compensation that partners became used to. Some reasonably argue that the resulting conflict of interest led to the ultimate demise of the $70 billion giant.

2. **BRANDING** Looking back on the example of MarchFIRST, it's interesting to note that one of the two major objectives of the campaign was to boost recruiting. However, not one ad identified the company's products, services or market positioning. Taken at face value, we might argue that spending up toward $30 million in an effort to get the right talent at the right time is admirable (if not a little overboard) for a consulting firm whose business is so people-dependent. Indeed, MarchFIRST reported they experienced a jump in job seeker resume submissions from 2,000 in May to more than 11,000 in July.[4] Without a clear message about who they are and what they do, it is hard to believe that these 9,000 additional candidates had any sense for the culture, expertise, and knowledge-base integral to building the firm's success. Ultimately, workforce chaos overwhelmed all attempts to establish the brand.

3. **REPLICABLE METHODOLOGY** Within IT and beyond, consultancies have been criticized for their "one size fits all" approach and "yellow school bus" syndrome. As the KPMG ad campaigns of the late 90s highlighted, often times a consultant team constituted of recent campus hires did look like they just got off a yellow school bus. However, these two are not mutually exclusive. Client perception is often that while the best consulting firms have strong points of view about how to improve business, sometimes consultants get too caught up in methodology. Inexperience on the front-lines begets heavier reliance upon standard methodology and procedure. To the extent that people became interchangeable players within a prescribed process, efficiency might have increased but overall value delivered suffered. For example, in the ERP world, big promises were made for end-to-end "business transformation" enabled by process methodology and leverage models. However, according to a study conducted by Boston Consulting Group, only 33 percent of outcomes were viewed as positive in terms of value creation, cost-effectiveness, tangible financial impact, and attainment of goals.[5]

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[3] Source: Optimize, "Square Off: Should the Feds Regulate Auditors?" March 2002.

[4] Source: I-Street, "But What Does it All Mean?" January 2001.

[5] Source: "Getting Value from Enterprise Initiatives: A Survey of Executives." March 2000.

MAKING IT WORK THROUGH BUILDING TALENT VALUE

Building Talent Value	Focus on building business through attracting, developing and retaining the key people in the firm.

Be it through going public, merging, acquiring or spinning off an entity, or increasing marketing dollars it's relatively hard to tell how successful professional services firms have been or will be in building franchise value. From our experience and through top professional services firms we surveyed[6], we know a big part of building a successful franchise comes from supporting it with the right talent. Here are what we believe to be the best and most timely talent management remedies in support of building franchise value.

REMEDIES: ATTRACTING

Do the best arrows in your recruiting quiver match your strategy/franchise value? Our survey of leading PSFs showed that no single recruiting route is favored consistently, but we did come to understand the following as the critical means for attracting the right talent:

- **Tell a compelling and consistent story**—Present an attractive and consistent strategic direction to candidates. Ensure that your story matches that of your marketing messages and other franchise building mechanisms. According to one law firm we surveyed, "articulating an attractive strategic direction and platform is essential to getting who we want." Another IT consulting firm noted, "providing a compelling vision for the future is what it's all about." Without an identifiable name, firms are essentially reliant upon a strong story: "We have recently changed our name and are re-branding—that means we have to tell our story well."
- **Be explicit about the monetary value proposition**—Be specific about how to make money at the firm—explicitly how will the candidate enjoy long-term wealth creation? As one company we surveyed indicated, "assuring candidates that they will create wealth for themselves" is the most challenging aspect in attracting key talent. Guarantees, although somewhat "de rigueur", do very little in driving performance behaviors that will yield financial gain over time. Laying out a roadmap for wealth creation is essential to creating long-term vision. It is important for candidates to know explicitly what it takes for them to do well, in addition to what it takes for the company to succeed, and the monetary implications of each.
- **Be aware of your reputation**— Reputation can mean smooth sailing or an uphill battle when it comes to recruiting top candidates. Be realistic about your company's persona—what you are, and what you are not. While it is important for a firm to differentiate itself versus its competitors, too much differentiation or faddish differentiation can be detrimental. Throughout the dot-com boom, many non-IT professional services firms struggled with the degree to which they should associate with being part of "the next big thing." As with all trends in business, striking the balance between embracing the new while maintaining the old is tricky. For example, in the face of many ex-McKinseyites emerging overnight as dot-com entrepreneurial celebrities, McKinsey had to decide the extent to which it wanted to jump on the bandwagon and start venture capital funds or dot-com offshoot ventures while maintaining the credibility and hard-fought and enduring reputation as one of the most prestigious firms to work for in the industry[7]. Although McKinsey set up "accelerators" and completed more than 1,000 e-commerce projects during the boom, blue-chip

[6] Semler Brossy Consulting Group and Heidrick & Struggles "Professional Services Survey: Attracting, Retaining and Keeping Key Talent Focused."

[7] Consulting Magazine, "In search of Camelot: The Best Consulting Firms to Work For." June 2001.

clients, which range from General Motors to Johnson & Johnson, remained the firm's true bread and butter[8].

- **Employ an engaging interview process**—Nothing speaks louder about your firm than the people who work there—and according to our survey results—it pays to put your best people forward. Several of our survey participants noted the importance of the interview process itself in drawing candidates in to work for their firms. In particular, firms cited the interviewers as integral to the success of recruiting efforts. "Interviews by enthusiastic partners are our most effective device," noted one law firm, while two other IT consulting firms mentioned, "meeting with top flight executives that the candidates respect" and "having a candidate form strong relationships, chemistry and allowing them significant exposure to the executive team." Contact with engaging "thought or business leaders," be it through group interviews, lunches, "open houses" or after-work-drinks, not only allows for candidates to hear what the firm is about, but also provides a strong indicator of the high importance placed on recruiting the right talent.

REMEDIES: DRIVING PERFORMANCE

When we asked our survey participants about factors that drive performance, they told us that as their businesses grow more complex, the nature of partner pay is changing. Indeed, more and more firms are departing from the traditional "eat what you kill" compensation structure to include other non-traditional measures centered around collaboration, firm development and account management as well as whole firm oriented measures. One IT consulting firm mentioned "looking to foster greater cross-line business collaboration," while another noted, "placing a stronger emphasis on the results of the whole." The measures used, the approach to pay and management of performance were at the forefront of our survey participants' minds.

- **Select and use the appropriate performance measures(s**)—Show us a partner pay plan, and we'll tell you the implied business strategy. Without a doubt, when it comes to partner behavior, you get what you pay for, as undoubtedly illustrated in Andersen's demise. While its important to link strategy to performance measures and pay, taking the extra step to understand the outcomes (both intended and unintended) is imperative. Dependent on the stage a business is in, it may be more or less important to generate line of sight between a partner and the measures that directly impact his/her pay. We think of this in terms of managing pay after the fact or managing the opportunity upfront.

- Retrospective
- Focus on managing the outcome of pay
- Often discretionary
- Paternalistic philosophy: smoothing out spikes and dips in performance
- Group-oriented measures

- Prospective
- Pre-identified economic game
- Often formulaic
- "Sink or swim" philosophy: pay directly reflects spikes and dips in performance
- Individual-oriented measures

[8] Business Week, "Inside McKinsey." July 8, 2002.

A "managing the opportunity upfront" approach to pay typically uses one to two "hard" performance measures that are more directly related to the individual or small team. "Soft" indicators like work quality, cooperative behavior, and practice contribution are foregone. These simpler pay programs/systems work best when a compelling reason for short-term revenue generation exists, for example:

- Revenue growth goals are above the normal rate—say 15-20% per year in a normal economy.
- Strategy requires the firm to acquire significant market share or scale.
- Firm is publicly traded and needs to produce consistent earnings growth.
- Large, semi-variable investments are being made, i.e., opening new offices.

The benefit of managing the opportunity upfront is that it creates an implicit economic game for the participants. Messages pertaining to what success looks like are clear.

To the extent the firm strategy/focus is more complex or diffused, a "managing after the fact" approach that tracks several key performance measures is likely more appropriate. As a company grows more complex in terms of lines of service/practice areas and geography, the focus tends to shift from the individual to the group performance, and naturally, more complex measures (e.g., days of sales outstanding (DSO)/receivables, profit margin (based on realization, utilization), cross-selling, implementation rates, ROI/cost saving for the client). As indicated by one law firm, "we're placing more emphasis on qualitative factors and changing the value of business development, account management, key relationship management, and doing the work." Furthermore, the ability to formulaically determine a pay outcome becomes increasingly difficult and may become somewhat discretionary. The relative importance of overall office, practice and individual measures varies. Similarly, execution, implementation and collaboration may become as important if not more, than sourcing, selling and closing deals.

- **Monitor your approach to pay**—Although determining measures and an approach to pay typically utilizes the most manager time and effort, management of your chosen approach is integral to its success.
  - A "managing the opportunity upfront" approach can lead to franchise compromising behaviors (e.g., selling work that does not fit with the strategy or brand). In addition, due to the individualistic and often formulaic nature of the pay program, double counting costs generated from overlapping individual sales activities could become problematic.
  - A "managing pay after the fact" approach can sometimes lead to lowering the firm's "rainmakers'" sense of urgency around sales. Furthermore, with less of a direct focus on revenue generation, managers should be vigilant about managing the prospect pipeline and backlog to ensure a healthy revenue stream.
- **Hold regular performance conversations**—Although this may sound obvious or even banal, the culture of autonomy afforded partners in many firms makes recurring performance conversations a big change in practice for many PSFs. In addition to discussing performance standards, holding or forcing performance conversations helps build culture and reinforce signals until they become abundantly clear. One multi-national accounting firm noted "at the partner level, our focus has been on development and more candid feedback." Perhaps it could be said that the ideal performance management system—whether managed before or after the fact—rendered some 80% of all performance to be clearly understood and valued within the system. Syndicated conversation can address the remaining 20% and in so doing continue to examine, clarify and reinforce "what good looks like".

Remedies: Creating Wealth

A common theme throughout survey responses—be it during attracting, motivating or retaining—was ensuring wealth creation opportunities up through the ranks and at the partner/executive level. We've identified three effective ways to do it:

- **Maintaining a sense of the whole or "partnership"**—It appears that the successful publicly traded professional services firms have tried to maintain a more "partnership-like" compensation structure. For example, at Accenture, the CEO and other executive officers continue to be compensated on the unit basis used prior to their IPO. The company reports no use of traditional "corporate" bonuses, stock options/restricted stock grants or any other long-term incentive plans. In comparison, KPMG Consulting (now rebranding as Bearing Point) has moved to a more "corporate structure." Up to 25% of cash pay was replaced by stock or stock options when the company went public. To the extent that partners hold publicly traded stock rather than privately held partnership shares, exiting becomes a great deal easier. Although initially, any options or shares are held under vesting schedules and other holding restrictions, over time a partner is more able to sell their investment in the firm. Steady stock price growth becomes increasingly more important, and in the event it dips, a firm risks losing partners. We believe companies like Accenture are at an advantage because their partners invest in jointly owned partnership units. Therefore, the decision to sell cannot be the result of a fleeting moment.
- **Ensure capital accrues to internal talent**—Anecdotal evidence indicates that companies who sold a large portion of their firm in the public market have not been as successful compared to companies such as Accenture and Watson Wyatt who sold less than 30% of their firms. With 70% of the company publicly traded, the question of earnings distribution inevitably arises as the majority of mouths to be fed are outside investors versus internal contributors. How much outside capital is accruing to the internal talent? Similarly, for non-publicly traded firms, significant debt means people other than the partners of the firm have a claim on cash flow earnings that crowd out partner rewards.
- **Steady wealth accumulation over time**—The tried and true nature of the best professional services firms is that partners do not "get rich quick". Wealth tends to be generated through smart outside investments. Some individuals market-timed the last cycle and realized great wealth; some will no doubt do this again in the future business cycle. However, the large majority of successful firms are growing wealth for their partners over time. Because of this, we believe that more firms should consider providing long-term wealth accumulation vehicles such as:
  - Deferred compensation programs
  - Split dollar/other life insurance
  - Financial planning

  These not only serve as a means of generating wealth for but also retaining the individual.

Remedies: Retaining

While no firm should expect to retain key partners without steady wealth creation opportunities, our survey participants identified several non-financial aspects of their employee value proposition as well as less positive vehicles such as contracts and non-compete agreements. We mention each briefly below.

- **Non-financial aspects**—Several firms we surveyed indicated that paid sabbaticals are an effective retention vehicle. One IT consulting firm noted that paid sabbaticals "allow employees to disconnect from work and recharge their batteries." Not surprisingly, our survey respondents noted that a strong performance management system, beyond its role in attracting key talent, is also an effective retention vehicle. One IT consultancy indicated, "skill development is one of the most critical investments that we make in our people to ensure they realize how much we value their contributions."

- **Contracts and agreements**—Contracts, non-solicit and non-compete agreements are both an understandable and sensible way of restricting the ability of talent to take clients, people and intellectual property with them if they go. Excluding law firms, approximately half of the other PSFs we surveyed indicated that they had contracts in place for partner level employees. Furthermore, (again, excluding law firms) almost all limited the ability of a partner to solicit/serve current and past clients of both the individual and the firm between one and three years following departure. Similarly almost all firms prohibited any solicitation of employees. Although these tools sometimes serve as powerful deterrents for leaving the firm, these are obviously not the tools to build a strong, motivated and engaged workforce.

CLOSING

Over the last two decades, many professional services firms have been built–several have been taken public, more still have merged, a portion have diversified their service offering, many have succeeded, a number have failed, and some have been wiped out entirely. As the economy mandates that we take time to regroup and contemplate these recent activities, we are able to begin drawing conclusions about PSF successes and failures. Arguably more so than other sectors, professional services firms have been traditionally, and still are today, reliant on their people and the expertise they bring to generate value for the firms. We believe that to the extent firms keep their eye on the talent ball—effectively managing the people side of the business—their franchise value will grow. ◆

Remedy Elements	Convergence	Branding	Replicable Methodology
Attracting	■ Be prepared to explain and show why convergence makes sense—not only the efficiencies, but also the (positive) impact on the individual partners ■ Real cases of success with broader offering ■ Real cases where knowledge has been leveraged	■ Show that your brand image is consistent with internal operations ▸ What do customers say about you? ▸ How far do the brand's aspirations stretch beyond current reality? ■ Tell a compelling and consistent story throughout the interview process ▸ Provide interviewers with key points to stress, but let them tell their own experiences in their own words ■ Be aware of your reputation—be prepared to use the positive and address any negatives	■ Ensure that your process and methodology are effectively presented ▸ What differentiates the methodology? ▸ Is it adaptable? ▸ How is quality-of-life for the "doers"?
Driving Performance	■ Develop process and systems (such as rewards) that support collaboration among and across newly formed partner groups ■ Promote cross-fertilization of partner skills, contacts, etc. following convergence	■ Design reward systems that are consistent with external branding—what is important to the firm? ■ What partner results translate into achieving the brand's aspirations?	■ Promote knowledge sharing among partners? ■ Make sure that the manner by which partners "perform" is sustainable and preferably replicable—stay away from "one-offs"
Creating Wealth	■ Ensure that wealth creation vehicles develop a shared sense of the whole as opposed to only individual or "old-co" contributions	■ Design wealth accumulation vehicles that promote and reflect firm strategy—e.g., strong, steady meaningful growth	■ Tie long-term wealth creation to sustainable execution of strategy, e.g., reward for optimizing leverage from methodology

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