Cass Business School
CITY UNIVERSITY LONDON

Cass Centre for Professional Service Firms - Second Discussion Forum

The way ahead: Leadership and change in challenging times

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'Those who claim to see the future are lying, even if by chance they are later proved right.'

(Traditional Arab saying quoted in David Hare's new play about the financial crisis, The Power of Yes).

A year after the financial crisis began, over 100 professionals, policy makers, academics, and students, came together at the Cass Centre for Professional Service Firms to discuss 'the way ahead' for the professional services sector. This was the second discussion forum organised by the Centre in the series **Leadership and Change in Challenging Times**.

Professor Laura Empson, the Centre's Director, brought together a distinguished panel of leaders from three firms in different sectors to reflect upon the changes of the previous twelve months and to consider what lies ahead. They were: **Richard Murley** (Managing Director and Co-Head of UK Investment Banking, Rothschild), **Jeremy Newman** (Global CEO, BDO International), and **Stuart Popham** (Senior Partner, Clifford Chance, and Chairman of TheCity UK).

Citing David Hare's quotation, Laura Empson recognised that it was foolish to pretend we could predict the future with any certainty, but asked the panelists to reflect upon the following:

What has changed forever and what is fundamental and will endure?

Laura Empson introduced the discussion by arguing that the past year has been a time of profound and irrevocable change in the world of professional firms. But this experience has been simply a rapid acceleration in a process of change that has been under way for most of the past decade – a fundamental shift in the balance of power away from professional service firms and in favour of their various stakeholders: clients, competitors, regulators, and professionals. She then posed the panelists a series of challenging questions to lead them into a deeper exploration of these changing power dynamics.

Professional service firms and clients

The balance of power used to be tipped strongly towards professional service firms. 'There was a time when clients looked up to their professional advisers' Laura Empson (pictured) argued. 'Clients were essentially ignorant and needed access to your esoteric knowledge. They came to you with complex and serious problems and they trusted you to do your best for them. This put you in a very powerful position – and enabled you to charge them a great deal of money.

'But in recent years, as commercial pressures have increased, the concept of professionalism itself has changed,' she said, 'It is now less to do with commitment to a code of professional ethics, and more about total dedication to serving the client.'

She pointed out that clients have become increasingly sophisticated consumers of professional services, sometimes with their own in-house teams supplemented by panels of preferred suppliers. In the current economic climate, many have taken the next logical step and forced professional firms into commercially unsustainable levels of fee discounting.

Was this a picture that the three professionals on the panel recognised?

Certainly they all admitted that relationships had been tested over the past year, and that things had changed, particularly when it came to charging very high fees. Stuart Popham said that clients had started asking them to 'share' some of the pain: to roll over some fees, for example, or not to charge if a deal did not go through. He thought that law firms were beginning to re-frame the concept of the billable hour. 'There had been a tendency to assume that all hours had equal value,' he said, ‘Now people are beginning to think that some hours may be more valuable than others.'

At Rothschild, Richard Murley described a different pattern to client relationships, based on being paid by the deal, rather than by the hour. Between deals, in the investment banking advisory sector, bankers try to stay close to the client. It was noticeable that Rothschild bankers were now tending to have different conversations with their clients than they had when the market was booming. When there was little need for a discussion about M&A, for example, there were now increasing numbers of clients talking to them about issues that they might previously have discussed with their full-service banks.

Jeremy Newman pointed out that most accountancy firms are built on audit relationships, which are usually long-term. The recession had increased the importance of the stability of audit relative to other areas of the business, and BDO were certainly experiencing a 'different dynamic' in its client relationships.

Laura Empson (pictured with Stuart Popham) asked whether the pressure to discount fees reflected a change in clients’ attitudes to their professionals towards a more instrumental, price-based relationship: 'from trusted adviser to high-class hooker?'
Stuart Popham replied that the deeper and better established the relationship had been in the first place, the more enduring it tended to be – those relationships that had been based on who was the cheapest provider were always prone to disintegration.

'You do have to work between deals,' he said, 'And it is that work that makes the difference between being a trusted adviser, or simply being the hired help.'

So is the recession in fact simply widening the gap between those clients and firms committed to fostering 'old-fashioned' professional relationships - which may in the short term involve some flexibility on fees - and those willing to continue to play the game of competing on price?

The idea of resurrecting apparently long-dead professional concepts was echoed by Richard Murley. 'When there are fewer deals, we need to get out more,' he said. 'If clients don't want to talk to us about M&A, we need to find things that they do want to talk to us about. For example, at the moment, we find that they want to talk about financing. Everyone is becoming more skilled at wider conversations: the old corporate finance skills are coming to the fore.'

While all on the panel are old enough to remember what the 'old corporate finance skills' were, Jeremy Newman pointed out that this was not the case for the younger people in their firms. The gap between economic crises has been so long this time, he said, that many professionals have simply not experienced one before, and they have therefore not developed the interpersonal skills that are needed to nurture client relationships at such a challenging time.

Professional service firms and competitors

'The recession has potentially dramatically reconfigured the whole market,' said Laura Empson. The traditionally stable competitive landscape for professional service firms (along with its high barriers to entry and static, reputation-based competitive hierarchy) had been under threat prior to the recession. Technology was making it possible to deliver professional services in new ways – from new countries and from new model firms – but until last year these changes were still happening only at the fringes.

With the recession, all that changed: 'Long established firms have disappeared or merged. Newer, smaller firms have popped up to grab power as others' power wanes,' she said.

Jeremy Newman (pictured) pointed out that, far from suddenly popping up, some firms had already been repositioning themselves before the recession. BDO, for example, had for some time been coming up behind the Big Four accountancy firms. However, the inevitable price-cutting had accelerated even the most subtle shifts in the market: 'Everyone is suddenly moving into everyone else's territory.'

Laura Empson asked if the problems of the large global banks, and the carving up of chunks of their international businesses, had put an end to the ambitions of the global mega law firm? Indeed, 'were Slaughter and May right all along?'

Whilst carefully conceding that Slaughter and May's strategy 'was right for them', Stuart Popham (pictured) continued to stand by Clifford Chance's global strategy. 'More and more clients are looking for uniformity in a globalised world, and they derive comfort from getting advice from one firm,' he said. 'No model is right for everyone.' He did, however, acknowledge that the crisis had 'made us look at what we were doing', and thought that they had probably 'moved on a decade in a couple of years.'

'Once you reach a certain size, you have to be highly international,' agreed Richard Murley (pictured). 'Big clients are working on the global stage, and unless you can talk intelligently to them about this, you will be stuck in a very small box.'

Professional service firms and regulators

Professionals used to be able to rely primarily on self-regulation. As Laura Empson described it, 'Professionals were carefully selected, socialised, and accredited by the professional bodies and the member firms and, after that, it was largely assumed that they would do the right thing.'

'The Big Bang brought about increased regulation of the banking sector – ENRON and its aftermath brought a similar tightening of external control in the accounting sector. The Legal Services Act brought a similar kind of state intervention in the functioning of the profession.'

'Right now, given the hostile mood of public opinion, it will be a brave professional who tries to make a case for holding back the tide of increased regulation.'

And, indeed, none of the participants really did make the case. 'Accountants post Enron accepted that self-regulation was no longer tenable,' said Jeremy Newman. 'Bankers too should accept the need for external regulation.'

Coming straight to the point and the focus of public hostility, Laura Empson asked Richard Murley (pictured) if there was a case for external regulation of bankers' bonuses. He acknowledged that right now the public believe that most people in the City are paid too much, 'There is deep anger, and people in the City have to recognise it. But, no one wants to be first to make changes, because they are worried that people will leave.'

So perhaps it will have to be up to the regulators? Appropriately, perhaps, given his new role as Chairman of TheCityUK, which aims, among other things to encourage a better understanding of the financial services sector in the UK, Stuart Popham (pictured) said, 'We need to re-balance the public opinion of financial services.' He believed that, following the banking crisis, everyone associated with the financial services industry is 'tarred with the same brush': they are all assumed to have no social value, to be recklessly gambling with other people's money. But of course financial services are a significant part of the economy, he said, and trust in them needs to be restored.

Jeremy Newman agreed that 'Regulation gives confidence to Joe Public and to the Government.' However, he pointed out that regulation only works if people actually behave professionally and ethically anyway: 'It is impossible to regulate every single aspect of our activity'. And that is why, he said, the professions have to embrace regulation and accept it, and demonstrate that they can work with it, so that it does not become too heavy-handed, impede the flow of capital, and slow business down.

For, while accepting the need for external regulation, there was clearly a desire to avoid 'knee-jerk regulation', brought in 'purely to satisfy the voters.'

Stuart Popham questioned how people defined 'better' regulation: 'For some people it's more; for some it's less regulation, or clearer regulation.' He also argued against the dangers of uncoordinated national regulation, which could lead to a system of 'regulatory arbitrage' - although Laura Empson (pictured) mischievously pointed out that this 'would justify the global law firm model' – and lead to a fee bonanza for lawyers.

There was regret that the era of self-regulation should have ended. 'It's a shame that the word professional doesn't mean what it used to,' said Richard Murley, 'That the whole emphasis now is on an external force making sure that the things you once took for granted are now expected of you. In the old days I'm sure that 98 per cent of people did behave absolutely admirably and responsibly, but we have a tidal wave of regulation in all professions to deal with the two per cent who didn't. But I agree with Stuart and Jeremy: it's the real world, and it will happen.'

Professional service firms and professionals

Changes in the balance of power have perhaps been most marked in relationships between professional service firms and the people who work within them.

'Young professionals used to be prepared to wait patiently for the prize of partnership and did not expect very much from their firms in the meantime,' said Laura Empson. 'That changed as the war for talent shifted power away from employers and towards employees. At the same time, young professionals were looking at their partners and thinking ‘I don't actually want to live like that.’

With the recession, the balance of power has swung back to employers temporarily, as people are grateful to have a job. ‘But in the long term,’ said Laura Empson, ‘We're looking at a reassertion of the power of the individual professional at the expense of the professional service firm.’

She asked Jeremy Newman and Stuart Popham if, after spending years carefully nurturing the partnership ethos and culture in their firms, they had undone all their hard work by announcing partner redundancies.

Jeremy Newman (pictured) said that he saw no reason why redundancies should affect a firm’s position as a pro-people employer. 'If you are a partner, or indeed a member of staff, you know when revenues are down and that business is unsustainable. You recognise that the axe will fall somewhere. It is far better for the firm to acknowledge it and have those discussions openly and honestly, than for people to wait around, knowing that it will be done by stealth.'

Richard Murley suggested that there might even be an element of restoring focus and increasing the emphasis on quality, which could be reassuring to the people left behind. In bull markets, he argued, there is intense competition for talent and some firms may end up making 'marginal' hires. In tough times, it can become painfully clear who these people are. While making them redundant is highly distressing for all concerned, it can be a means of improving performance within the firm as a whole. Providing the firm is seen to be fair and sensitive, it can be encouraging for juniors, and clears the path for their progress.

While Stuart Popham (pictured with Laura Empson) agreed that a firm should not be seen to accept mediocrity, he felt that, in a partnership, some partners might have preferred to ride out the peaks and troughs together. In a partnership redundancies can hit very hard. In Clifford Chance, he explained, they took a vote amongst the partners - in a meeting that had the highest turnout and one of the highest majorities for a decade. 'They recognised that it was in the best interests of the partnership, if not in the interests of individual partners, and it made it easier for the leadership to make a decision,' he said.

Laura Empson wondered about the proverbial turkeys voting for Christmas. Stuart Popham agreed that 'some partners were voting in certain knowledge of what might happen to them.' But he argued that, if you consider the alternative – 'that partners vote just in their own self-interest – then it's not really a partnership.'

'In the partnership model you are acting as custodian for the next generation of partners, and you have to hope that the people you make partner are there for the best interests of the firm as a whole,' said Jeremy Newman. 'If you are just hanging on in there, you are potentially damaging what you are handing on to the next generation. If you understand what partnership is really about then you must recognise that it is time to go.'

Conclusion

So much has changed in the past year but has it changed forever? What is fundamental and will endure? The panelists, coming from three very different firms and three very different sectors, displayed a remarkable degree of unanimity.

Whatever else has changed, the power of strong relationships remains fundamental to the professional service sector – between professionals and their clients, and among professional colleagues. Ultimately professional services must be based on trust – in individuals and in the organisations they represent. The firms that come out of the recession in a healthy state will have been careful to rebuild and sustain that trust.

But in terms of what may have changed fundamentally, the recession has called into question some long-held beliefs about how to price professional services and how to reward the people who deliver them. It is too soon to say whether these changes will be sustained as the economy recovers.

As one Senior Partner in the audience said in the ensuing discussion: 'It is all very well clients asking you to share the pain. The question is, will we get to share the pleasure afterwards?'