

Differentiation through Innovation



How legal practices can survive during tough times by cutting through the dross and actually understanding what clients want and providing it, via meaningful innovation and differentiation.

There seems to be growing dissatisfaction in the international legal services market. The pressures on private practices right now are accumulating and they are not just recessionary, although the fallout from the Western credit crunch is bad enough. Business clients are, for example, beginning to challenge items they call 'commodities'. Most projects contain administrative functions or routine processes, which have been the source of inflated billing to date. Clients are demanding that even the elite practices strip out these items and find ways to differentiate between valuable professional insight and routine tasks. For some clients this is simply a plea to make a tight budget stretch a little further. In some places, though, it is the result of senior lawyers building up their in-house team. Nevertheless, across the world there seems to be a requirement from even those businesses with the deepest pockets to understand what the values of different legal services are to their organisation.

This pressure itself results from a fast growing international trend: the informed buyer. Not only are internal counsel qualified lawyers, many have also had a spell in private practice and know the dynamics of the supply industry. As 'poachers turned game keepers', these internal specialists tend to challenge and scrutinise the external service they receive. More than one private practice has had to answer recently for the hours billed to a project in more exacting and demanding ways. These informed buyers also lead to that most difficult of all specialists, the purchasing director. Since the Enron debacle there has been a relentless trend to involve purchasing specialists in the acquisition of high-end professional services. Although the prime motivation is transparency and good governance, the leaders of many of the world's largest organisations have found that professional buying has reduced

cost and mitigated risk. So panel reviews are becoming more demanding and even the most well disposed clients are being forced to look for savings by their peers in buying roles. Jonathan Dutton, chair of the Australian Institute of Purchasing & Supply, said last year that this is a worldwide trend and that purchasing specialists are currently learning how to buy professional services effectively.

In addition to all this, changes prompted by regulatory pressure are affecting an area of work important to many legal practices: mergers and acquisitions ('M&A'). This runs through city partnerships and effects many parts of these firms. I know partners in the United States and Europe who have been shocked at just how much of their practice has been decimated by the crash of M&A related work. In the past, enduring firms have simply moved practitioners into counter-cyclical work and waited for the city to come back. I suspect though, that this time it will be different. The Western investment banks have long followed the ebb and flow of financial bubbles, allowing inefficient and risky practices to survive because reward has been so large. Yet even before the latest crash many were beginning to question how they buy professional help. A number of bankers, for instance, were beginning to reflect on the fact that parts of M&A were so routine that lawyers were only really needed to 'paper a deal'. And if change was in the air before the credit crunch, it will be inevitable after. The world population will not forgive their politicians if the bankers are allowed to return to work with no legislative or regulatory reform. It may be that in highly lucrative niches, like private equity, vast earnings will allow sloppy margin control to continue, but not elsewhere.

This, in turn, will hasten one other

pressure that is increasing for professional practices: external funding and city listing. There is an inexorable drive amongst the world's professions to limit the risk of partnership. Many have now become limited liability partnerships ('LLPs') and others are looking at different forms of ownership and funding. In accountancy, for example, the 'integrators' (publicly owned companies that buy small practices and create networks) are back with a new and effective model. One in Australia has grown very fast in recent years and is now just a whisker behind the Big Four. In law, some partners, such as Slater & Gordon in Australia, have floated their firms, whilst others have looked for different types of ownership structure. Californian employment practice, Littler Mendelson P.C., is a public corporation which has structured its governance like a corporate board, and New York's Axiom is a network firm. This is a fundamental change, which alters the financial dynamics of a practice and changes partnership behaviour. Over time, publicly owned practices become leaner, cheaper and meaner. So, even if a partnership does not need external funding, it is likely to find itself competing against viciously focussed, streamlined and effective public competitors.

These forces, then, are accumulating and unlikely to diminish. Even when we come out of the international recession it seems unlikely that professional practices will be able to return to the halcyon days of fat margins and luxurious lifestyles. They prompt a number of questions: Is the legal profession going the way of the accountants, who seemed to be traumatised by similar pressures a decade or so ago? Is it inevitable that the value of legal services is eroded as both business and domestic clients become better educated second guessers? Are lawyers, like many professions before them, going to have to increase span of

control and introduce robust processes, so that junior associates lead most client engagements?

The hunt is on to improve productivity with the same sense of urgency and creativity as has occurred in other industries. Partners in many different firms are thinking about serving clients in radical new ways and this is likely to lead, perhaps for the very first time, to true differentiation in legal services.

How Does Differentiation Occur?

The changing legal services market is not unique in its experience of these remorseless forces. Others have been through this before. In many demanding and difficult markets, suppliers have learnt to thrive by creating a truly unique offer that commands the attention of their clients. In luxury goods, for example, the world's leading brands have learnt to create wealth from the perceived differences of, say, perfumes. The problem is that this looks sensible and obvious in retrospect. But perfume is really just smelly water. There is no logical reason why Estée Lauder should be perceived to be so different and more desirable to, say, Yves Saint Laurent. Yet, the world over, people flock to these different, desirable offers.

Other suppliers have succeeded in creating difference between business offers. The business class travel in Virgin Airlines is perceived to be different to Singapore Airlines for instance. In management consultancy, clients, who see no difference at all between law firms, will understand the very different stance of, say, McKinsey, Deloitte and Bane. In fact, leading thinkers in international legal services have been trying to create the 'magic bullet' of differentiation for some time, and there are signs that it is beginning to happen.

The reason many legal practitioners (and even their marketing support people who are supposed to understand these issues) find it difficult to differentiate is that they start in the wrong place with the wrong assumption. Many assume that all clients' want is the best advice at the cheapest price. They then look to their own firm to try to discover ways in which they might be different to competitors. However, this really begins with a perhaps unfamiliar approach to the needs of clients.

History shows that those who have succeeded in creating viable, profitable differences in other industries, have done so through a systematic understanding of the needs of their buyers. Profitable differentiation starts with the desires of the clients. 'Perceptual maps', for example, are used by the leaders of many different businesses to set direction and to gain insight. They have two axes: perceived price and perceived quality. By understanding these and ranking the buyers' views of all the significant offers, leaders can deduce and set direction for their own firm. The resultant diagram is a perceptual map of buyer needs, called so because it concentrates on their perception. In other words, these views may not be technically correct or factually accurate because they represent the perception of different human beings; with all their frailties, emotions and illogical desires.

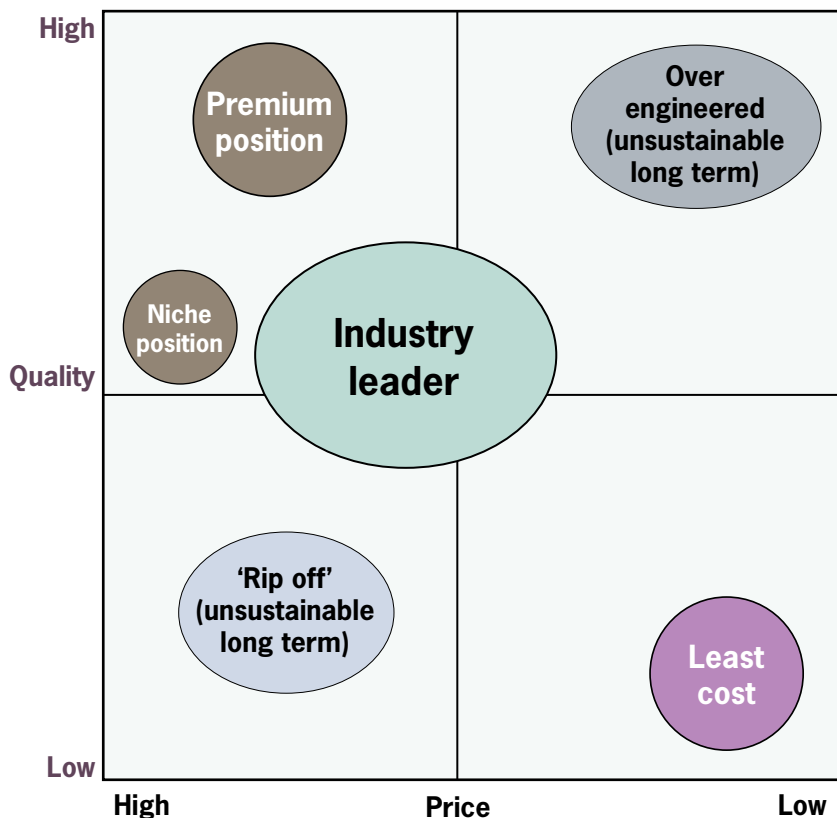
Contrary to popular belief, they will not all want the cheapest offer. They will want a mix of features and price that represents value to them. Some seek a features rich offer with a high price and some a basic offer at a low price. The

output of this understanding, reflecting buyers' needs and requirements, is shown in Figure 1. The buyers' ideal purchases will be scattered around a line (the line on which suppliers can achieve long term position). In a market that is not distorted by monopoly or regulation, most buyers cluster around the middle; a position that the leading firm can dominate. (see figure 1)

This 'market leader' normally takes centre stage; see Figure 2. It has the offer by which all are judged. It sets the price/quality expectations of the whole industry and has the power to change the whole market. The premium position (normally a long standing firm) is taken by a features rich offer at a high price, whilst the 'least cost' supplier strips out all that is possible to achieve low price. Various niche providers set themselves against the market leader and survive by providing a different offer.

The prime use of the tool is to work out where the client's values lie and to move the firm's offer towards them. Positioning the firm in this way, is a guide for policy. The leadership can use

Positioning – the perceptual map (figure 1)



it to reach consensus on the position that they want the firm to take in the market. It is therefore a very powerful tool to guide strategy debate amongst leadership teams.

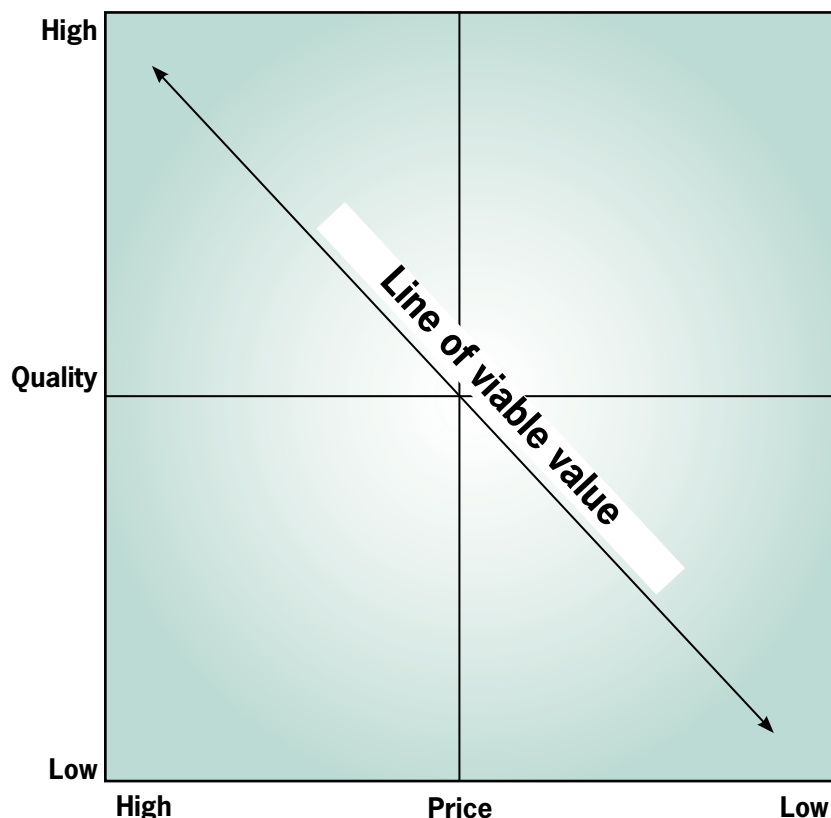
Innovation in Practice Management: a Proactive Approach to Differentiation

In 2006 IBM launched a massive international advertising campaign called, 'innovation that matters'. The objective was to suggest that they had the means to help corporations innovate in all parts of their organisations ('structurally, financially and operationally'), not just for form's sake but in a way that actually benefited the organisation. Whatever their own intentions, the effect was to, once again, put emphasis on the word 'innovation' in business circles. Since then, innovation has become a topical subject with books, seminars, summits and conferences dedicated to it. Leading consultancies have published research and white papers on innovation needs. Although this might seem a little faddish, there is no doubt that legal practices across the world are investing time and resources in innovation because clients are demanding fresh approaches. (A symptom of this is London's Financial Times' annual award for 'the most innovative law firm'). It is also clear that innovation management is at the heart of the successful differentiation achieved by organisations in other industries and is beginning to create real differences between the offers of different law firms.

Innovation is the management process by which an organisation captures, cultivates and exploits initiatives. In recent years a number of practices have managed to create a successful method of harvesting creative insight, in addition to ensuring that creativity is stimulated in the first place. The venerable British law firm, Allen & Overy, has, for example, an innovation committee that reports to its leadership team on programmes to capture creativity on behalf of the whole partnership. They have successfully launched a series of IT based services which, at the most sophisticated level, automate a number of clients' processes.

Some organisations use a formal innovation process. This occurs most commonly in companies that create

Buyers seeking different value propositions (figure 2)



and industrialise consumer services. American Express, for instance, has a highly developed process with strict controls over eight development 'gates'. The normal approach is to set up a sub committee of the leadership team. Innovators are given a budget to complete initial feasibility. They are then required to return to the management group for further funds to go to the next phase. The committee reports to the main leadership team on the progress of all new concepts.

Others, by contrast, emphasise smallness. For instance, in a recent speech, British entrepreneur Richard Branson attributed part of the success of his Virgin empire to smallness. His policy, he said, was to break units in two once they had reached around thirty people. He had found that it maintained entrepreneurial spirit and kept overheads low. This approach is founded on a story that has become the stuff of business legend. In the 1960s, the American multinational 3M nearly missed a major opportunity. Its' Dr Spencer Silver had produced a 'low-tack reusable adhesive (glue which

didn't stick well). He saw the potential to create what became 'Post It' notes. Unfortunately, all rejected the concept. However, he did not give up on the idea but began to manufacture samples, which he gave to the board's secretaries. As they asked for more, word spread and demand grew until the manufacturing capability for the notes took over his supportive boss' office. The company eventually accepted the innovation, which became one of its most successful products. Then, as a response to the fear that it's large, bureaucratic structure might miss another product opportunity, it broke down into small cells. It claimed that this was responsible for a number of subsequent innovations.

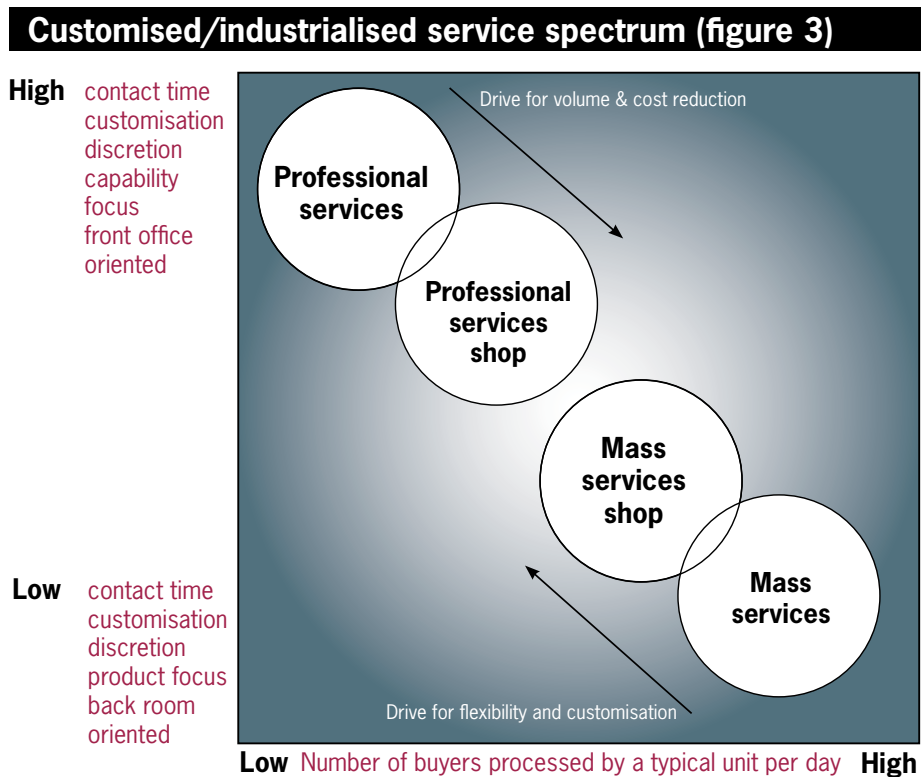
Innovation through smallness is ideal for partnerships. It is, in fact, probably the reason for the enduring success of many professional practices over the last two centuries. Even in the largest firms, success lies in their individual practices which, like cells in a living organism, evolve and respond to changes because they are run directly by a partner – an

owner of the business. So, fostering an innovation by dedicating a practice to it is common in the professions. Typically, though, this is intuitive and not called innovation management or part of any structured, recognised process. Partners often have to fight against resistance to establish a fresh idea. Experience suggests that leaders can improve success if they make explicit a mechanism to identify, nurture and prioritise ideas in this way.

Still others have successfully innovated through outsourcing. In the early 1970s a young advertiser, David Crayton, had the European decorating company Polly-cell as a client. He was in discussion with them about a marketing campaign when they began to talk about a huge mistake. They had tried to move into paint and, because they were a glue company, were about to discard the resultant stuff. It was far too white and sticky, but the main problem was that it dried as a rubbery skin. It could not be used as gloss paint under any circumstances. The company asked David if he could use his creative skills to save some of their investment. He went back to his agency and used his team to work through benefits, features and applications. They came up with the idea that it might be, in a country with old housing stock, 'a treatment for ceilings which did not need painting'. It was eventually launched as 'Polytex' and became a successful product for the company. David went on to found Crayton, Lodge and Knight, a leading creative agency. These agencies pitch for work in similar ways to which partners do, and work on mandates to turn creative ideas into viable products and services; and do so in the professions. The agencies need to learn the very different environment of professional services and they need to work with open-minded partners, but once underway, the two sides can be very constructive.

Practical ways of harvesting and exploiting innovation

The 'diffusion of innovations' is a recognised phenomenon by which societies learn new concepts and adjust to them. It involves word-of-mouth, education and subtle forms of publicity. It has been used to encourage development in many contexts (from first-world drug use to third-world water sanitation). One sociologist, Everett Rogers, says of it: 'This information exchange about new



ideas occurs through a conversation process involving interpersonal networks. The diffusion of innovation is essentially a social process in which subjectively perceived information about a new idea is communicated from person to person'.

So, the acceptance and growth of an innovation occurs through dialogue amongst a network of inter-related people. It's all about relationships; as many partners would say about the growth of their own franchise. In fact, there is a specific type of innovation diffusion which occurs in the professions (Figure 3). The professions range from high-end customised services, at the top left of the diagram to the volume consumer services in the professional service shop.

Innovative concepts evolve through a commoditisation process. For instance, McKinsey partners usually undertake complex projects to solve unique client problems, working at the extreme upper left of the diagram. However, if their practice meets a problem several times, the type of engagement will be given a name and a new concept is born in

the industry. Other suppliers will then take up the offer, creating processes and tools to handle it. It moves down the 'industrialisation' line, picking up volume but losing margin. Eventually the approach becomes commonplace, is captured in software tools, is trained in professional academies and undertaken by clients themselves. It becomes a professional service commodity. Offers like double-entry bookkeeping, portfolio planning and process reengineering have all followed this course, and it is seen throughout the professions today.

Different offers suit different firms at different stages in the commoditisation journey. A high-end strategy firm like McKinsey pioneers new concepts, whereas one of the IT-based management consultancies, such as Accenture, might be better suited to volume, process-based offers. Practice leaders can identify potential innovations for their practice if they have a clear view of the concepts that are appropriate to its competencies and by adapting ideas from others. As famous strategy professor Ted Levitt said, 'Innovation is not only about completely new ideas but also about the sensible adaptation and improvement of concepts pioneered by others'. By

clearly understanding the offers that suit their firms as it focuses on their clients, differentiation will naturally evolve. Leaders who really grasp this should be able to seriously contribute to their practice's profits.

It is not at all easy for anyone to create an offer, which is distinct and different from others, but it has been done many times before. In consumer products, for instance, British Potter Josiah Wedgwood (1790) and American entrepreneur Henry Heinz (1890) managed to create unique offers in businesses that were harsh, cheap commodities, and in pre-industrialised, war-ravaged economies. In consumer services, leaders as different as Marshall Field (1910) and Richard Branson have been able to create distinct, unique offers for which buyers were happy to pay more. And, for the sake of doubt, this has also been achieved with sophisticated business services. From banks like Rothschild and Coutts, to consultancies like McKinsey, educated business leaders, similar to lawyers, have been able to create and maintain distinct, valuable offers. If they can make themselves wealthy by crafting unique offers, so can lawyers in Singapore.

Commoditisation, cheapness, erratic cash flow and price slashing are not, by any means, inevitable. It just takes a little forethought, application and durability to achieve genuine differentiation.

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Notes

- 1 Laurie Young is one of the few advisers to the professions who has been a partner in a leading firm (PricewaterhouseCoopers). He has also founded, built and sold a practice. His clients have included: Deloitte, Allen & Overy and Russell Reynolds. Laurie also spoke at a recent Law Society of Singapore seminar on the topic 'Differentiating Your Professional Services in a Crowded Marketplace: Innovation and Strategic Focus as a Source of Margin Maximisation'. See www.lauriedyoung.com



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