



## Newsletter, Spring 2010

### INTERVIEW WITH DR CHRISTOPHER MCKENNA, DIRECTOR OF THE NOVAK DRUCE CENTRE FOR PROFESSIONAL SERVICE FIRMS



Christopher McKenna's interests focus on the development and strategies of professional firms and their role in the global transformation of business, nonprofits and nations. A founding member of the Centre and now its Director, he is also a Fellow of Brasenose College. After graduating from Amherst, McKenna worked on Wall Street and in the City before completing a history doctorate at Johns Hopkins. Before coming to Oxford, Chris taught at Wharton and has held research fellowships at Yale University, the Harvard Business School, and Georgetown as well as visiting appointments at Warwick and Toulouse.

#### Tell us about the Centre's new agenda

The Novak Druce Centre is shifting from an internal to an external perspective. Our objectives have evolved from a narrow focus on the internal management of PSFs to exploring the broader issues confronting them - the challenges of becoming more entrepreneurial and of globalising services. So we are less concerned with issues such as the oversight of employees and managing careers and more concerned with issues of global expansion, outsourcing, the creation of new markets, strategies for building new practices and the diversification of the workforce – in all of these areas taking into account the diverse and changing spectrum of organisations and activities across the PSF sector.

#### What are the most important recent changes in PSFs?

The last twenty years saw a tremendous expansion in PSFs. With globalisation and the growth in markets, the rapid rate of expansion meant that one of the biggest

concerns was simply to get the right people. That 'search for the stars' has certainly not gone away. But with the downturn and the readjustment in markets and the new emphasis on regulation, leading firms across all areas are having to rethink and be more precise in what their expansion should look like, where their centres of expertise should be and where they might pull back.

We also saw the emergence of interdisciplinary firms competing across areas and disciplinary divides. That is still the case. But regulatory pressure is putting that strategy in a new context, and we are seeing refocusing at geographical, disciplinary and practice levels. Outsourcing, incidentally, fits this paradigm quite well, as a way simultaneously to expand and to refocus.

#### How has the financial crisis affected PSFs?

The most heated controversies of course have centred on PSFs working with the financial institutions. Changes in the financial



**In October 2009 Oxford's Novak Druce Centre for Professional Service Firms was launched thanks to support from the law firm Novak Druce + Quigg LLP. With a noted patent re-examination practice and more than 70 attorneys and professionals in offices across the US, Novak Druce + Quigg LLP focuses exclusively on intellectual property (IP), aiming to help its clients successfully navigate the complexities of US IP law. One of its most celebrated cases enabled the technology behind the BlackBerry™ handheld device to clear the hurdles of existing patents and become a huge global success. For the past three years the firm has won first place in the WORLDleaders International IP awards.**

sector are bound to have major knock-on effects. But consulting firms are also having to change, and shift their practices back very quickly to focus on areas like cost-cutting. And advertising agencies too have been greatly affected through a combination of the downturn and the decline in the importance of print media.



But, behind all the changes, we are seeing an acceleration of deeper trends. These are forcing radical new shifts and encouraging the emergence of new types of firms. Take law firms: Today's leading law firms were players in the 1930s but their future dominance was not obvious. They could be found anywhere in the then top twenty law firms. What happened – and again this is counterintuitive - was that those firms that focused on individuals fell away but those that focused on banks succeeded.

#### **Do you see parallels between current controversies and the past?**

I see striking parallels with earlier scandals. The economic cycle of boom and bust may have exercised greater sway in those periods but - as we have seen - there are still liquidity traps today. And current scandals map very closely onto those of the 1930s and the nineteenth century. Madoff and Enron look an awful lot like the Krueger Swedish Match Company scandal of the 1930s, and the legislative impact, post-Enron, is beginning to look an awful lot like the aftermath to Ivar Krueger (see below).

#### **How can the Centre help PSFs meet their challenges?**

We take the long view historically and geographically on the basis of a lot of research. As a result we can offer theoretically and empirically based advice to firms - across disciplines and professions - that can help them avoid getting trapped and help them see opportunities beyond the current cycle. In addition, we can help bridge the gaps between regulators and practitioners by bringing them together in a non-threatening environment.

#### **What is the essence of the Centre's approach?**

We focus on issues of real and pressing concern but we approach them from an academic angle and then work back to the

answers. We gather information through conversations with leading PSFs, interviews, archival materials or other sources of data, then interpret it in the context of appropriate theories and frameworks and come up with something that we hope is accurate and original. The most interesting answers, incidentally, are often counterintuitive, and unpredictable.

#### **A major outcome of the meltdown has been the call for stronger regulation: what are the implications for PSFs?**

History reminds us that professionals have a crucial role to play in the regulatory system and that their power comes in part from working in tandem with the regulatory process. Firms need to stop attacking regulation and work with it – not be at odds with the development of new accounting standards, for instance, but to collaborate in creating them. A knee-jerk resistance to regulation on their part is not a wise move. The key lessons are the need to work with regulators to build new markets and by so doing to build leading positions in those markets. New professional practices will emerge as a result, and these will be both lucrative and powerful.

#### **How important is the Centre's Oxford connection?**

The Centre is very lucky to be in Oxford. Geographically, it is close to the heart of Britain and to London. Many business schools find it hard to reach outside their walls. Here we are embedded in Oxford's colleges and have associates across the university from other disciplines. Across the University we benefit from relationships with law, socio-legal studies, economics, politics and – my own original discipline – history.

And we should not forget that Oxford is the training ground for very many professionals. The vast majority of the Saïd Business School's students are already members of PSFs or join PSFs on graduating. That means we talk on a regular basis to young

professionals like lawyers, architects and engineers and to students involved with these firms, and can see that interface at close quarters.

The Saïd Business School itself is strongly international and interdisciplinary. And the Novak Druce Centre for Professional Service Firms is closely linked with the School's other specialist research centres, such as the Corporate Reputation Centre – of which Tim Morris and I are both members. Another important connection is with the School's Centre for Taxation Studies. These adjacent 'pockets' of specialist knowledge are invaluable in that they allow us to expand our activities into otherwise inaccessible areas.

But it is not just within the university that we connect with other resources. We are in regular contact with the leaders of PSFs, and of course we also have a close relationship with Novak Druce, which allows us to see a professional service firm from the inside.

#### **What will the typical PSF look like in five years' time?**

Superficially, much the same, I suspect. In a downturn the tendency is to lock down your current form. But as growth rates accelerate and standards become more international, more people will be drawn in from outside local jurisdictions to enable the firms to reach out into new markets around the world. Correspondingly the people working within the firms will also be different. I believe that in backgrounds, training and international connections and networks tomorrow's professionals will increasingly resemble the business students I am currently seeing come through Oxford.

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## LEADERSHIP IN GLOBAL PSFs



**Andrew Pettigrew**  
*Professor of Strategy and Organisation at the Saïd Business School, University of Oxford*

Formerly Dean of the Bath School of Management, Andrew Pettigrew has also held appointments at Yale, London Business School, Warwick and Harvard where he is a Visiting Professor. He was awarded an OBE in 2009 for his services to higher education.

Andrew is embarking on a major study of how leaders in PSFs operate and handle the tricky business of brokering the expectations of the professionals in their firms. Pettigrew, who until now has focused on the leadership of change in the public sector and health services, believes PSFs offer a unique microcosm for research.

'Until now PSFs have been driven by a growth model and a 'learn fast, earn fast', mentality but are now facing recession. They are knowledge-intensive organisations particularly concerned to maintain professional credibility and reputation. Professionals are also used to being autonomous. All of this puts unusual pressure on their leaders.'

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Andrew expects the study to generate even broader insights. 'Much leadership study is a-contextual and focused on a single point in time. We will, if you like, be looking at leadership in three dimensions - how it operates in the context of specific strategic issues over longer periods. The project, he adds, should throw new light on a neglected field: 'There is no exemplary research study to act as a guiding star. Leadership research should be at the heart of business schools but it has tended to be peripheral.'

The study, carried out in collaboration with PwC partner and visiting professor at Bath University, Ron Collard, will last three to four years and focus on PSF leaders engaged with major strategic issues. 'Identifying the issues will be up to the firms but they will be international, substantial and directional.'

## DECISION MAKING IN PSFs



**Tim Morris**  
*Professor of Management Studies at the Saïd Business School, University of Oxford*

Tim Morris studies change and innovation in law, architecture and management consulting firms. Recently he has focused on leadership and the challenges of strategic decision-making in professional firms. 'The big issue is the extent to which the financial crisis has really structurally changed these firms. The jury is still out but I think that some firms will see radical changes. Existing associate-based structures are difficult to sustain in an increasingly commoditised world and it is unclear how the deal will work out for younger associates in future.'

Tim has been especially active recently in publishing research. His co-authored chapter in the forthcoming Handbook of Organizational Decision Making analyses decision making in PSFs in relation to two dimensions: easy/hard and strategic/non-strategic. Surprisingly, the authors found easy/ non-strategic decisions could often 'flare' into hard ones in PSFs. 'Decisions which affect professional values or identities stir emotions and create friction amongst professionals who perceive such changes as an attack upon their own values or identity ... Many traditional professional partnerships are consensus-based democracies, but, as such, they are subject to the lobbying, scheming and bargaining which occurs in any other political arena in order to achieve agreement on decisions amongst diverse

individuals and interest groups ... Effective managing partners therefore learn and draw upon a range of tactics to build collective agreement and to nurture support.'

In another co-authored article to appear in Organizational Dynamics he describes the emerging 'multiplex' organizational form in transnational professional service firms, which 'allows them to capture the benefits of deep specialization ... whilst also meeting the demands of their international clients for "seamless", customized, global service.' At its heart is a client management system, supported by a 'culture of reciprocity that glues the whole thing together.' Tim also participated in the recently published MCA report, 'The Value of Consulting'. Among its conclusions was that 'the UK consulting industry was worth around £59 billion to clients in 2008 – a return of £6 for every £1 invested'.

## WILL LAW FIRMS OPT FOR OUTSOURCING?



**Mari Sako**  
*Professor of Management Studies at the Saïd Business School, University of Oxford*

Mari Sako is interested in how business enterprises are governed in different ways in different locations, with specific focus on human resources and global supply chains. As a Senior Fellow of the ESRC/EPSC Advanced Institute of Management Research, she previously studied productivity and performance in business services and the impact of outsourcing. At the Novak Druce Centre she is pursuing research on the globalization of law firms and the impact of legal process outsourcing on the legal profession.

Mari is extending her previous research into outsourcing in sectors such as manufacturing to the field of law firms. 'Law is interesting,' she says, 'in part because it is such a



restricted profession and therefore a unique microcosm in which to view the impact of new developments like outsourcing.' Another aspect that interests her is how relevant the 'relational contract' – something she has again studied in other fields of business – is in the legal sector. 'Lawyers like to pin things down in very detailed contracts but I found talking to them that the situation was much more complicated.'

Mari spoke on 'Innovation in Services: Possible Futures for International Law Firms' at The Law Society's International Conference in London last November. She also presented a paper, 'Make or Buy Decisions: Theory & Evidence in Legal Services', at the Georgetown Law Center Conference in March 2010, 'Law Firm Evolution: Brave New World or Business as Usual'. Looking again at the legal sector from a broader business context, she applied traditional theories of the firm to law firms' decisions and found that they stacked up surprisingly well. Her next step will be to test these conclusions in a round of research in US law firms starting in September.

**PSFs: NETWORKS FOR MANAGEMENT INNOVATION**



**Tamar Parush**  
*Post Doctoral Research Fellow, Novak Druce Centre for Professional Service Firms*

Tamar Parush completed her doctorate at Tel Aviv University before joining the Novak Druce Centre in October 2008. One of the features of the Saïd Business School school she most appreciates is its informal and friendly atmosphere, which is conducive for 'intellectual dialogue'.

Alongside her interest in PSFs as producers and carriers of management innovations, she is also interested in the management of art organizations and the boundaries between art and business.

Tamar is particularly fascinated by the analogies between conducting orchestras and the management of professionals in PSFs. Tamar is particularly fascinated by how orchestras learn and work, and has participated in Oxford Strategic Leadership Programme sessions on the links between conducting and leadership.

In her work at the Centre, Tamar pursues research into the emergence and diffusion of management innovations, focusing on PSFs as central actors in this process. 'PSFs are important sources of innovation in the field of business and management', she says. 'They are constantly developing new management techniques and business strategies, and distributing them among their clients. At the same time, they are also deeply affected by the very same innovations. Each wave of innovation-diffusion leaves its mark on the organizational structure of PSFs, in the form of a new practice area.'

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***'The strategic challenge for consultancies is to balance innovation with commitment to their core skills and expertise'***

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The meltdown, Tamar believes, may slow down some processes of innovation diffusion. Nevertheless, PSFs will continue to operate in an environment characterized by hyper-innovation and hyper-competition. 'We live in a globalising world, with rapid developments in markets and technology. Business is increasingly not just cross-national but transnational. There is rippling-out effect in ideas. One of the things I've looked at is the time lags involved in this.'

The strategic challenge for PSFs, Tamar stresses, is to balance innovation with commitment to their core skills and expertise. 'Hyper-innovation can also be dangerous. It might lead to loss of focus, loss of professionalism, and overemphasis on exploration at the expense of exploitation. PSFs should engage in innovation while avoiding these dangers.' Whereas Tamar's current research focuses on management consulting firms, she is interested in extending her future work to include PR and advertising agencies.

**STRATEGY TOOLS FOR CONSULTANTS**



**Suela Haxhiraj**  
*Doctoral Scholar, Novak Druce Centre for Professional Service Firms*

Suela began her DPhil studies at Saïd Business School in October 2009. Before joining the programme, Suela completed the MPhil in Innovation, Strategy and Organisation at the University of Cambridge. Prior to her MPhil studies, She was awarded her MBA in International Management in Pforzheim, Germany, with Distinction. During these studies she was awarded the "Biosthétique Prize" for excellent results and social engagement.

Suela's first degree (equivalent to a BSc) in Finance/Banking was taken at the University of Tirana, Albania. Her professional experience includes working within Beiersdorf HQ in Hamburg as part of a specialised unit within the strategy and marketing department of the company, as well as several economics-related projects (at the OSCE - Organization for Security and Cooperation in Europe) and a marketing-related position (in the FMCG sector/Pepsi) in her home-country of Albania.

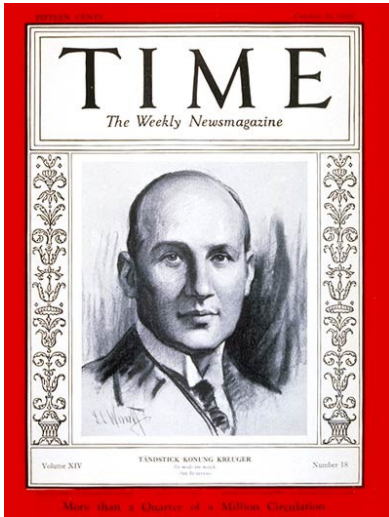
Suela is principally involved with the questions of what sense management consultants make of the range of strategy tools they use during their assignments, and what roles these tools play in their everyday practices. 'Although strategising efforts are documented in organisational settings, accounts in the consulting domain remain scarce,' she says. 'Understanding strategy tools is intrinsically linked to their use and the purposes they serve in the everyday practice.' Suela is about to start an 'action research' phase of her study, currently negotiating to participate in – and contribute to - a project relating to knowledge management within the strategy practice of a consulting firm.



**THE LONG SHADOW OF THE SWEDISH MATCH KING**

*Chris McKenna outlines his research on the history of white collar crime.*

Ivar Kreuger, a household name in the 1920s and 1930s, is largely forgotten now. Yet by any standard the fall of the international match maker was equivalent to Enron: a catastrophic failure that transfixed the public and changed the way business operated for generations.



By the mid-1920s, Kreuger had reached the height of industrial and financial power. With pronouncements able to move markets and his global monopoly, Kreuger was the modern equivalent of Warren Buffet and Bill Gates wrapped up in a single individual. Keynes called Kreuger ‘the greatest financial intelligence of his time’. Had his crimes never been discovered, he might have been viewed, like J. P. Morgan, as an elder statesman of international finance.

Yet, three years into the Depression, as his creditors were closing in, Kreuger killed himself. His holding company was bankrupt and that the losses within Swedish Match exceeded that country’s national debt. Even compared with current corporate malfeasance, the scale of Kreuger’s crimes remain unparalleled.

In building his empire Kreuger wielded two potent weapons, including the use of local (often secret) agents to threaten and bribe

competitors. His greatest financial weapon was the provision of state loans in exchange for monopoly rights. In the hyperinflation following the First World War, European ministers found it difficult to borrow money and desperately needed access to the capital markets. Kreuger turned to the United States, where his reputation as a financial wizard enabled him to raise hundreds of millions of dollars. Kreuger, as much as anyone, facilitated the flow of capital from the expanding American economy to the European countries that desperately needed cash.

But in reality Kreuger’s empire was a fraud. He had been borrowing twice over, pledging the real sovereign bonds against the debentures owned by investors in the States and, unknown to them, also against loans by European banks. When times were good and stock markets rising, Kreuger could keep his Ponzi scheme going. But as his investments lost value in the 1930s, the fraud became harder to conceal. And so, like Madoff in our day, it eventually unravelled.

Kreuger had learned to manipulate the watchdogs whose professional judgment was supposed to guard against white-collar crime. His professional advisers in America and Europe assisted him in building his transnational empire. Kreuger was the ‘Mr Wired’ of his day, constantly ‘emailing’ his advisors in the form of telegrams to provide information but also to pump them in return. They were desperate for the information only Kreuger could provide. With the rise of global markets followed by the 1929 Crash, when they were at a loss to understand what was going on - and Kreuger seemed to know everything.

***‘The shape of the modern corporation is as much a response to fears of the grasping fingers of corporate fraud as the hand of modern management’***

Kreuger’s legacy casts its shadow to the present. His crime resulted in a contraction of the process of globalisation - a fear that haunts capital markets in the present climate. More positively, the modern apparatus of securities regulation arose from the ashes of

his empire. Like the lawyers and accountants paid to clean up after Enron or Madoff, the professionals who struggled to re-organise Kreuger’s affairs came away fundamentally changed. The result was a generation of professionals who spent their lives trying to impose tighter regulatory and ethical standards. The shape of the modern corporation is as much a response to fears of the grasping fingers of corporate fraud as the hand of modern management.

Dr Chris McKenna’s book, *The World’s Newest Profession: Management Consulting in the Twentieth Century*, won multiple prizes on its appearance in 2007, including the Newcomen-Harvard Book Award. He is now working on a follow-up, *Partners in Crime*, on the history of white collar crime. With chapters on US railroads in the 1870s, the anti-bribery movement of the early 20th century and a comparative chapter on the development of tax havens in Europe and the Caribbean, one of its most fascinating sections is on the now little-remembered scandal surrounding the ‘Swedish Match King’, Ivar Krueger, whose global business empire collapsed in the 1930s.



Chris discussed his book at Novak Druce + Quigg LLP’s ‘Oxford Comes To Florida’ in December 2009, to Oxford Analytica last September in Christ Church, at a Max Planck Institute conference in Cologne in January, at the BAC Conference held at De Beers’ HQ in February and at a conference sponsored by University College London at Ernst & Young’s London offices.



**RUN WITH THE GAZELLES BUT EAT WITH THE LIONS**

*Mari Sako predicts the future for international law firms using business parallels.*

**Over the past two decades lawyers and law firms have boomed as never before. The number of solicitors in England and Wales doubled from 50,000 to over 100,000. And what was true domestically was even truer internationally. Global legal services revenue was \$458.2 billion in 2007.**

But legal services, faced with the challenges of globalization, regulatory changes and the financial crisis, are at a crossroads. Economic downturns create opportunities for innovation, which is all about discontinuous, unexpected change. Business history is littered with examples of leading firms being swept aside by new entrants in waves of 'creative destruction'. Take the computer industry as an illustration of the dynamics involved in successfully surfing the waves of discontinuity.

In its initial era of dominance, IBM was a classic vertically integrated company. But faced with competition from Apple Computers in the PC market IBM decided it could not keep up on all fronts and outsourced its operating system to Microsoft and its microprocessors to Intel. This was the beginning of the end of IBM as a hardware computer company. With IBM's outsourcing decisions, new players came to occupy horizontal industry segments - Microsoft in operating systems and applications software, Intel in chips, and many IBM-compatible assemblers.

Was this horizontally disintegrated structure stable? No. Companies sought opportunities to capture profits, not only by specializing in specific technologies but also by bundling products and services. Thus, IBM struck out for new territory in business services. This back-and-forth between vertical and horizontal industry structures might be seen as a figure of eight or a spiral double helix (like the structure of DNA).

Innovation in legal services is also all about discontinuous changes. What the economist

Joseph Schumpeter wrote a century ago is still relevant today: discontinuous change happens as a result of five things: the introduction of a new product or process, the opening of a new market or source of supply of intermediate goods, or a new organization design. For law firms, discontinuous change is happening as a result of his last two factors - new sources of supply and new organizational design.

The value chain for law firms is disintegrating. This possibility had existed for some time, with new ICT technology. Much of legal knowledge can be standardized, systematized, and packaged for delivery using self-service and smart systems. Moreover, the billable hour, which developed as a common way of charging clients, has come under severe attack, as the notion of professional autonomy and self-regulation came into conflict with the notion of business efficiency and consumer interest. Combined with the availability of new locations as sources of supply of talent, ICT has pushed global corporations in the direction of offshoring. Global corporations currently have a choice of four possible offshoring strategies. A company can set up a captive offshore operation, as GE Plastics has done in India. It can engage a law firm, which in turn sets up a captive offshore operation, as Clifford Chance has done in India. Or it can use a law firm that sources from an independent offshore legal process outsourcing (LPO) provider. Finally, a corporate client can bypass a law firm altogether, and outsource and offshore using a legal services firm, as Rio Tinto has done with CPA Global.

This is now. But what of the future? One way to understand the possibilities is by articulating the consequences for law firms of competitive strategies pursued by LPO providers in places like India, the Philippines and South Africa. They could:

- Compete in scale and process. LPO providers like Integreon and CPA Global are already building strong positions in routine areas like contract review and document discovery. The end result could be the 'horizontalization' of the legal industry, with law firms ending up like the old IBM, outsourcing low-end work and concentrating on making advanced machines in-house.

- Compete by climbing up the value chain (resulting in 'vertical stacking'). Regulatory restrictions apart, LPO suppliers could accumulate the same capability and start to threaten their law firm clients. Offshore LPO providers like Bhodi Global and Quislex are planning to move into higher-end work such as drawing up deposition summaries.

- Compete by broadening the boundaries of the industry, bundling services together, just as Microsoft has done. Whether incumbent law firms or new entrants end up leading in such bundling remains uncertain. Providers like Evalueserve are already beginning to pull together legal, accounting and business research under one roof.

So, depending on their actions, law firms may end up an intermediary with a thick pipeline of business or be bypassed – dis-intermediated. Longer-term, the double helix model illustrates a further possible direction for legal services industry structure, as it oscillates between vertically integrated to horizontally disintegrated structures.

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***'Law firms may end up an intermediary with a thick pipeline of business or be bypassed'***

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Innovative companies have the power to reshape the boundaries of the industries in which they operate. The transformation of Apple Computers to Apple Inc., bundling the iPod, iTunes and iPhone, is a dramatic example of a company that was able to transform itself and take advantage of the discontinuous changes brought about by telecom and internet developments.

Will the most innovative legal services firm that emerges – the legal equivalent of Apple – be an incumbent firm or a new entrant? The answer to this - the most interesting question - remains uncertain. Several futures are possible, and the eventual outcome depends largely on the decisions taken by the legal profession. But remember the old adage: 'Run with the gazelles but eat with the lions'. That combination of the abilities to move fast and at the same time to identify where the value chain will be protein-richest will be key. Law firms, take note.