

CODEXX WHITEPAPER

Innovating professional services - Study of key challenges

Final report

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1. Introduction

What are the key challenges that lawyers, accountants, consultants and other professional service firms face when they seek to innovate? This is the question that I sought to answer as part of Codexx work on professional services innovation, and this study report is the result.

‘Innovation’ is one of those words that often create confusion as it can mean different things to different people. It is important to have a common understanding within a firm of what innovation is so that people can effectively collaborate on it. Considering innovation to be *‘creating value from ideas’* is a useful definition as it shows that innovation is more than just creativity – there must be a useful outcome. For business innovation, the criterion that innovation is *‘anything that is new to your business’*, encompasses both the ‘Do Different’ and the much more common ‘Do Better’ (e.g. incremental improvement) types of innovation. This is key as innovation within a business includes homegrown ideas as well as those taken from other businesses, other sectors and indeed anywhere else in the world (using the philosophy of ‘copy with pride’ as opposed to the far-too-common ‘not invented here’) – whether they are radical or incremental.

The other aspect of innovation that is important in a professional service context is the difference between *‘individual’* and *‘institutional’* innovation. Many business professionals would claim that they innovate regularly in their work – in information gathering, analysis or reporting. However, this is primarily what I would call *‘individual’* innovation. Such ‘innovation’ is personal, it is not codified or scalable (it may not even be valuable) across the wider organisation. Therefore the impact of such individual innovation is limited in comparison to what I call *‘institutional’* innovation. Institutional innovation affects many people through codified and scalable approaches such as new products/services, new ways of working and new strategies. Institutional innovation may well start as individual innovation, but the lone innovator creates something that can be used by others and not just themselves. The focus of this study is on creating ‘institutional’ innovation in firms and understanding the challenges that change agents face in doing this.

“People don't want to take risky ideas to the boss.”
Partner, Management Consultancy¹

Innovation is very much on the agenda for all progressive professional service firms – a heady mix of the economy, client pressure on fees, globalisation, the impact of the internet and deregulation has seen to that. I have explored the opportunities and methods for innovation in

¹ A comment from a survey participant. Comments from study participants are used anonymously throughout this report.

professional service firms in three Codexx whitepapers published in 2012². However, in my work with professional service firms, I find that change leaders – be they Partners or experienced associates – commonly encounter significant challenges in trying to innovate – be it a new way of working, a new product or a new strategy. Of course innovation is difficult to do for any business. But the nature of professional services and the history of professional service firms make innovation even more challenging. Why is this? There are two key reasons which I will briefly explore, as they provide useful context for the study results which I will review later.

"We've been in our functional silos too long and they're too deep."
Manager, Business Services

1. The professional service business model

The professional service business model is to generate profit by charging out the firm's partners and other fee earners to clients at a fee rate and for a duration that delivers income that exceeds their direct costs and the allocated portion of the firm's indirect costs. Therefore the operational focus in firms is on fee earners meeting their targets on billable time. Partner compensation is based on the firm as a whole achieving this. So not surprisingly, there is an inherent resistance to anything that takes fee earners away from chargeable work – and that includes innovation projects. Partners will resist as they see a risk that their team targets on chargeable work will not be met. Fee earners will resist as they fear that they will be penalized if they do not meet their yearly fee utilization targets and they have no incentive to do otherwise.

2. The nature and history of professional services

An additional factor contributing to a challenging environment for innovation in professional service firms is that some professional service sectors, such as law and accountancy, have enjoyed a long period (i.e. decades) of relative business stability with little need for any significant innovation. Therefore the dominant culture in many established firms in these sectors is one that encourages stability and so discourages innovation. The little innovation that has occurred has typically been driven by external regulatory change, direct client pressure or advances in technology rather than proactive leadership from within the firms.

In addition, the core objective of services provided by major sectors such as law and accountancy (e.g. due diligence, audit, document drafting) is to seek to minimise risk. This requires a work approach and employees that are detail focused and cautious in their approach. This creates behaviours and attitudes which can conflict with the approaches needed for effective innovation. However, in my experience in working with lawyers in particular, this risk avoidance attitude is a hindrance, but not a barrier to innovation – once a supportive environment for innovation is created (in the short term this can be done in workshops within a focused innovation programme).

² 'Smarter Working in Law Firms - Re-engineering value and cost', March 2012; 'Innovating professional service firms – Part 1 – Opportunities', May 2012; 'Innovating professional service firms – Part 2 – Establishing a system for innovation', August 2012. All these papers are published by Codexx.

The result is that few professional service firms have a strong history of sustained institutional innovation and fewer still will have a well-resourced system in place to deliver innovation. These are major challenges for would-be innovators, but they are not the only ones.

"We could get more out of our existing pool for talent if there was a transparent process."

Partner, Law Firm

2. The study approach

To get a balanced view of innovation challenges, I interviewed senior personnel from 15 professional service firms during 2012-13. The participating firms covered the following sectors:

| Sector | Number of firms |
|--------------------------------|-----------------|
| Law | 7 |
| Consulting & Business services | 4 |
| Accounting | 3 |
| Insurance | 1 |
| TOTAL | 15 |

The study examined predominantly large professional service firms. The median revenue of the surveyed firms was approximately £350m with median employees being approximately 2,500. Interviews (or sometimes an email exchange) were held with a Partner or senior executive. 14 of the 15 firms surveyed were primarily based in the UK, with one based in the USA.

Participants were asked to identify their 'Top 5' innovation challenges and a list of 10 typical challenges I have encountered in Codexx work with professional service firms was shown as an example. Many of those listed challenges were selected by participants and some additional challenges were cited. Participants were also asked to rate their firm against a scale of innovation maturity – as shown below:

| | |
|---------------------|--|
| NOVICE | – We have little or no formal innovation activity. |
| APPRENTICE | – We have active innovation, but little structure in it. |
| EXPERIENCED | – Innovation is important to us and we are working hard to make it a competency. |
| PROFESSIONAL | – Innovation is one of our competencies and we have an effective system to resource and manage it. |

This self-assessment was used to determine whether there was any correlation between the innovation maturity of a firm and the key challenges it identified to further innovation.

Participants' comments and scoring were kept anonymous to encourage open and frank discussion. Anonymised comments made by survey respondents have been used throughout this report to help bring the findings to life.

“There is lip service to innovation at senior levels due to the difficulty of making the required cultural change.”
Partner, Law Firm

3. The study findings

Looking first of all at the innovation maturity, the overall self-assessment rating is shown in Figure 1. A number of the firms positioned themselves between two of the categories (i.e. Novice/Apprentice and Apprentice/Experienced) so have been scored half in each. Overall, most of the firms considered that they were at an 'Apprentice' level of innovation maturity – with active innovation but having little structure to manage it. None of the firms ranked themselves as 'Professional', showing that they recognised that their innovation system was not effective enough for innovation to be considered a competency.

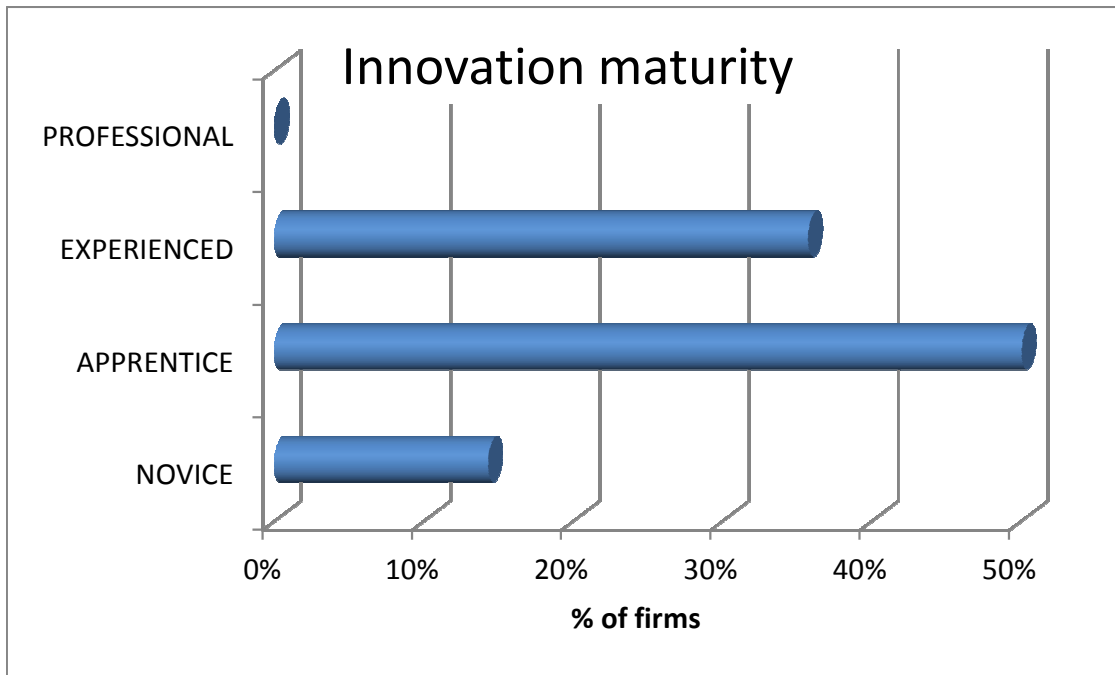


Figure 1: Innovation maturity of study participants (Note: 14 respondents)

The key innovation challenges identified by the respondents are shown in Figure 2. The identified challenges have been ranked by their frequency of selection. So a score of 1.0 for a challenge would mean that all respondents listed that challenge as one of their selected 'Top 5'.

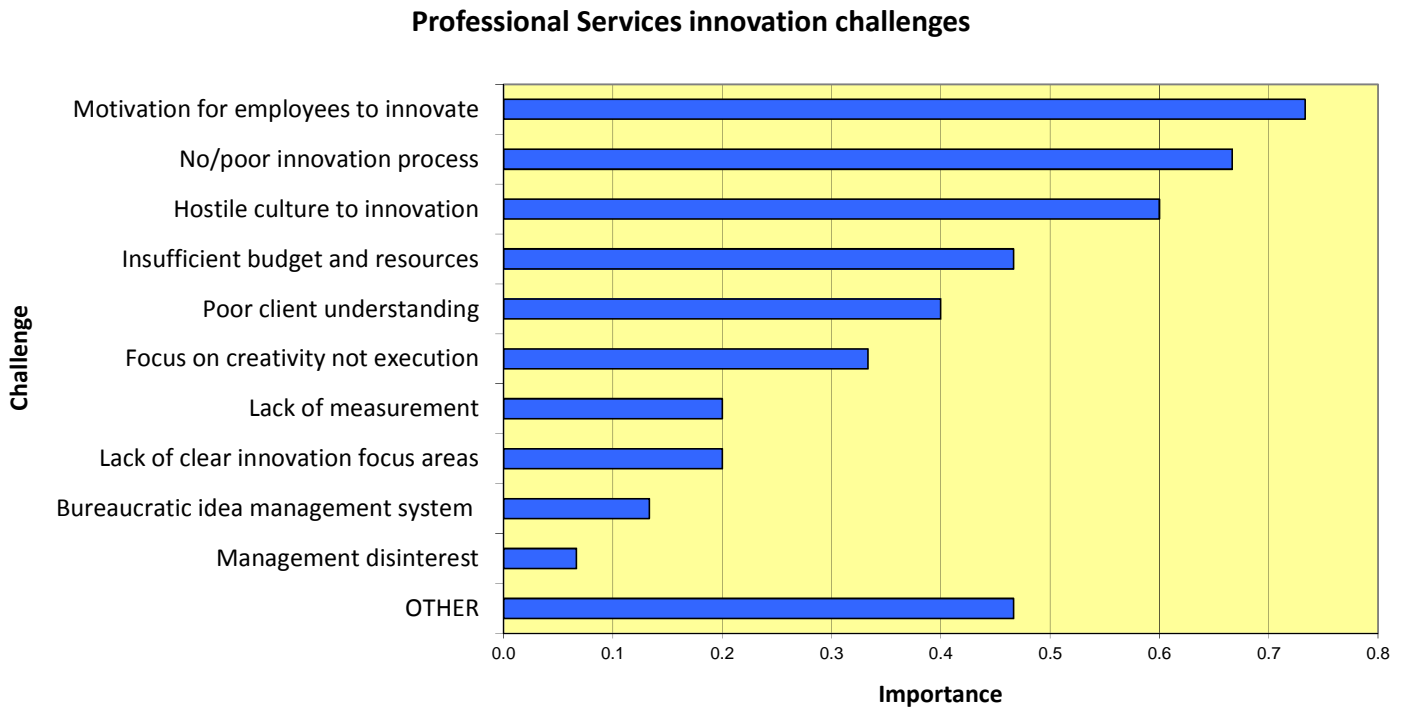


Figure 2- Key innovation challenges (Source: Codexx innovation survey 2012-13. 15 firms surveyed)

Two of the top three challenges are culture-related issues, each identified by 9 or more of the respondents. The highest challenge was 'the motivation for employees to innovate'. Firms see that in most cases there is not enough encouragement for employees to innovate. The second highest challenge identified was 'no/poor innovation process' – the lack of an effective process for gathering, exploring, selecting and implementing ideas. The third highest challenge was 'a hostile culture to innovation' which has some similarity to the highest challenge, the difference being that the first challenge covers a lack of *incentive* for employees to innovate which covers things like management encouragement and support and reward. This third-ranked challenge identifies an active *discouragement* for employees and managers to spend time on innovation.

The 'Other' category covers a number of other challenges that were identified by respondents. Some of these do overlap with the existing categories, but others capture additional challenges such as the difficulty of managing multiple stakeholders and the issue of functional and departmental silos which can limit the sharing and development of new ideas across the firm.

Seven respondents identified an additional challenge:

- *'Managing multiple stakeholders including IT, Marketing, Risk, Technical etc - any of which could kill the idea'.*
- *'Time is a big issue'.*
- *'Policy for innovation is not integrated within 'pay and rations'.*
- *'Strong Department silos limit innovation'.*
- *'Success with product services has limited people's ideas'.*
- *'Middle management resistance - senior management is supportive'.*
- *'The short term nature of professional service firms'.*

Strong silos are indeed an important challenge. Professional service firms typically organise themselves by competency (e.g. Corporate, Litigation, Real Estate) rather than by client. However high value innovation is aligned with the client service lifecycle and thus can occur at the interfaces between functions. For example a major innovation in aerospace jet engines was in selling engine performance rather than the engine itself, so-called 'power by the hour'. This demanded innovation across engineering, sales, finance and support – converting a product to a service. This had much more competitive impact than an engineering-only innovation.³ Thus to maximise the opportunity for major innovation, professional service firms need to improve collaboration between teams.

Another challenge identified was 'short termism'. This can certainly be an issue for innovation, limiting the firm's horizon. However, the need for short term impact can be beneficial in driving disciplines for 'time-boxed' development and staged deliverables – project management disciplines that are lacking in some professional service sectors (e.g. legal).

"Carving out real time for innovation instead of chargeable work is a major challenge. As an organisation we don't do enough of it."
Partner, Management Consultancy

³ Power-by-the-Hour is a term coined by Bristol Siddeley in the early 1960s. It was used to describe a support service provided for Viper engines in the dH125, HS125 and BH125 business jet aircraft. For a fixed sum per flying hour, a complete engine and accessory replacement service was provided, thus allowing the operator to forecast such costs with great accuracy, and thus relieving the purchaser of the need to purchase stocks of engines and accessories. In the 1980s Rolls-Royce re-invented the program, and claimed that "The key feature of the program is that it undertakes to provide the operator with a fixed engine maintenance cost over an extended period of time. Operators are assured of an accurate cost projection and avoid the costs associated with breakdowns." Source: Wikipedia

Impact of innovation maturity on selected challenges

Comparing those firms that assessed themselves at the ‘Apprentice’ level of innovation maturity with those that assessed themselves as ‘Experienced’⁴ few differences emerged, as shown in Figure 3. Both types of innovators identified ‘hostile culture’ and ‘budget & resources’ in their highest challenges. This is of course a small sample of firms, preventing robust analysis, but this does suggest the importance of these issues whatever the innovation experience of the firm.

| Top Three challenges identified | |
|---|---|
| ‘Apprentice’ - 4 firms | ‘Experienced’ - 3 firms |
| Insufficient budget and resources (0.8) | Insufficient budget and resources (1.0) |
| No/poor innovation process (0.8) | Hostile culture to innovation (0.7) |
| Hostile culture to innovation (0.8) | OTHER (0.7) |

Figure 3: Comparison of challenges faced by ‘Apprentice’ and ‘Experienced’ innovators (level of challenge in brackets)

4. Commentary on the study findings

In this section I have given a short commentary on the key issues behind each of the ‘Top ten’ challenges identified, ranked by their perceived importance and shared relevant comments made by the study participants.

“Motivation challenge for employees is that chargeable hours win.”
Partner, Accountancy

1. Motivation for employees to innovate

The key issue here is that the measurement and reward system in professional service firms is focused on chargeable time – time spent on other activities is perceived by fee earners to have low/no value. This is an obvious discouragement to motivation. This can only be addressed through Partner/Management support and new recognition and rewards aligned with innovation.

“Business case development and benefits measurement are difficult.”
Manager, Technical Services

2. No/Poor innovation process

A core foundation for effective innovation is a robust process that links ideas with delivered value (e.g. a new or improved product/service, a new way of working or a new pricing model).

⁴ This comparison excluded those participants that had assessed themselves as partially Novice, Apprentice or Experienced.

This process must guide idea development, selection and investment using appropriate criteria, and monitor and support development and implementation. Whilst such processes are common in the industrial sector, they are less so in professional services. Their absence means that innovation ideas from employees can struggle to be heard and in comparison poor quality ideas can be pushed through if championed by a Partner or senior manager.

“Hostile culture to innovation - often the case in partnerships that are doing well doing what they did.”

Director, Accountancy

3. Hostile culture to innovation

This issue scored highly in the survey, indicating that the respondents – senior within their firms – recognised that many firms effectively discourage innovation through a combination of leadership behaviours, organisational ‘norms’ (e.g. *“more of the same has worked well for us for 20 years so why change?”*) and the reward system.

“Time is a big issue - we're a cog of labour.”

Partner, Law Firm

4. Insufficient budget and resources

The key resource required for innovation in a professional service firm is time – particularly the time of fee earners and key support personnel. Time is needed to reflect on the business, to gain insight from clients, to analyse existing methods and brainstorm new ones, to develop, implement and deploy new solutions. Few professional service firms have established dedicated ‘innovation teams’ armed with methods and budget who can be used to support innovation projects. Once an idea has traction, the other resource barrier that typically emerges is IT resourcing.

“Our new offering was less successful as it took too long and had not enough client involvement in design.”

Managing Partner, Law Firm

5. Poor client understanding

Engaging clients early in the development of a new product/service is an effective way of increasing the chance that the new offering will bring value to clients. Many new ideas come from firm’s clients or from an insight gained into a client’s business. This is why deep understanding of clients’ businesses is key to effective product/service innovation. However, many firms have a transactional relationship with clients and do not invest enough time and energy to understand their business challenges and so identify innovation opportunities.⁵

⁵ For more information on this topic read *“Increasing client loyalty to drive financial improvement”*, February 2009, Codexx whitepaper.

"We have ideas but we're not good at making them happen."
Managing Partner, Law Firm

6. Focus on creativity not execution

There is a distinct difference between creativity and innovation. Creativity may be required at the start of the innovation process (even if it is simply to borrow an idea from another sector), but it has no value without execution. Firms can be guilty of under-resourcing implementation – for new products this can include insufficient resourcing for marketing and selling the new offering. The ‘long slog’ of implementation can be less attractive for employees and managers than attending a few brainstorming workshops to generate new ideas....

"Our culture and measures don't really support innovation."
Manager, Business Services

7. Lack of measurement

If Management measures innovation it shows its importance and sends a signal to the organisation. But few professional firms do so. And if a firm decides to measure innovation, it must make sure that the measures have credibility – measuring and targeting ‘new ideas’ can result in cynicism and poor quality of ideas (including ‘re-treads’) simply to meet Management targets.

"Change is often forced from outside, for example by regulations."
Director, Accountancy

8. Lack of clear innovation focus areas

Effective business innovation does not use a scattergun approach – it makes use of defined focus areas (e.g. aligned with business strategy or medium-term improvement campaigns). Otherwise the limited resources available for innovation will be diluted and make little business impact. If a firm wishes to get ahead of others it needs to proactively innovate - exploiting new methods, new technologies and new market opportunities – rather than simply reacting to external events.

"We have a bureaucratic review process. We have difficulty in dealing with radical new ideas."
Manager, Business Services

9. Bureaucratic idea management system

This challenge is closely linked to a ‘No/poor innovation process’ but focuses specifically on the management of new ideas. Some firms implement an idea review process which is onerous both for the idea suggesters and the reviewers. The energy and enthusiasm for innovation is then further sapped by a glacial decision-making process. Effective idea management systems apply

common sense risk management and seek to push decision-making down to departments where possible. So teams are empowered to 'just do it' for simple ideas impacting a department that can be implemented locally whilst management time is spent evaluating and developing the more complex or wider-impacting ideas.

*“Resistance is from middle management
- senior management is supportive.”*
Partner, Accountancy

10. Management disinterest

This was actually the lowest of the 'Top 10' barriers with only one respondent selecting it as a key challenge. The comment above is insightful in recognising that Management disinterest/resistance is often at a mid-management level in the organisation. This is logical, as it is at this management level where the daily tradeoffs of 'daily business' v 'innovation' are made.

However, from my experience innovation does not have *sufficient* interest from senior management in professional service firms. If it did, then many of the other challenges identified by the study respondents would have been addressed. Many firms will have innovation 'on the agenda' but it is at too low a level to receive much focus or resourcing.

5. In Conclusion

This short study identified key challenges for innovation in 15 major professional service firms (primarily based in the UK). Culture emerged as the key challenge, followed by weaknesses in the management and resourcing of innovation. These findings are consistent with Codexx experience in professional service innovation and re-engineering work.

Change agents in professional service firms can use this report to help them develop a strategy for improving innovation in their firm, by understanding the likely challenges they will face and putting in place approaches to best address them.

To be effective at business innovation over the longer term, an innovation *system* is needed. This is as true in a professional service firm as it is in any other organisation. Such a system weaves together key enabling practices such as culture, leadership, processes, resources and strategy to provide a supportive '*innovation ecosystem*' within the firm. The previous Codexx whitepapers published in 2012² explore the opportunities for innovation in professional service firms and the development of a suitable innovation system. A forthcoming Codexx publication will focus on addressing the common innovation challenge in professional service firms.

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About Codexx

Codexx was established in 2002 to help businesses transform their competitiveness through the application of best practices and systematic innovation. Codexx has worked with clients in the UK and across Europe in the Service and Industrial sectors, using proprietary innovation and re-engineering tools and a network model of accredited academic and business associates. Codexx has developed a number of solutions for professional service firms including:

- Smarter Working* – re-engineering of services/internal processes for service firms.
- F4i (Foundations for Innovation)* – assessment of innovation practice and performance.
- Innovation Accelerator* – provides the key foundations for a professional service firm's innovation system – at a fixed price.

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