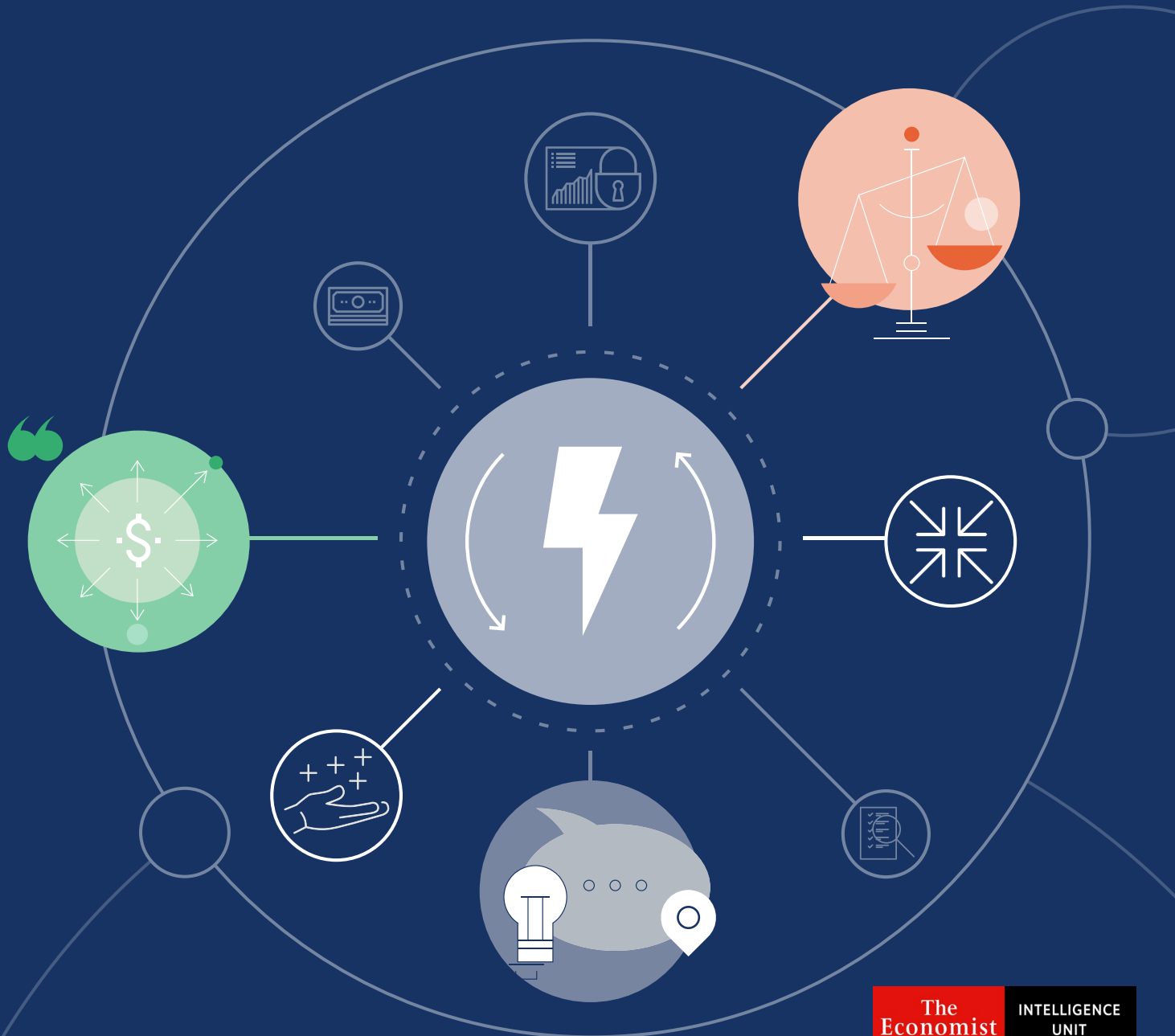


Globality

SMARTER, VALUE-DRIVEN PARTNERSHIPS:

Rethinking professional services in an age of disruption



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Executive summary

Businesses face a marketplace being rapidly transformed by digitisation, which is causing fundamental changes to what makes a firm competitive. The pace of change is frenetic.

With the help of machine learning, some law firms are reinventing themselves as legal services software companies that sell licences rather than advice. Large global accounting and consulting firms are taking some of their services in a similar direction, for instance in the area of regulatory compliance. Some manufacturing firms have expanded into digital services, offering other firms help with supply-chain management, product design and prototyping.

This trend is crucially also changing the kind of professional services partners that companies are choosing. Today, business units within firms are often seeking external partners not just to perform the same work in a cost-effective way or to a higher standard, but also to revolutionise how the work is done. This is adding complexity because externally sourced professional services are often neither centrally managed

nor centrally procured in companies, and the range of potential partners is exploding, as businesses consider alternatives to long-term relationships.

Nevertheless, change is coming. A recent survey conducted by The Economist Intelligence Unit and commissioned by Globality shows that many corporate executives are frustrated at paying high fees to large marketing agencies, consultancies and law firms for advice and services that do not always bring greater value to their organisations. As a result, some companies are getting the jump on their competition by considering alternative partners, such as boutique agencies and individual contributors, for specialist, highly skilled services.

Based on survey research and subject-matter expert interviews, this report shows that growing demand for digital skills and specialist capabilities is creating opportunities for multinationals to shake up their portfolio of incumbent service providers and consider smaller, niche suppliers and new tech-savvy firms. With these opportunities though also come challenges of sourcing and vetting new kinds of service providers and managing a larger portfolio of suppliers.

Executive summary

REPORT HIGHLIGHTS

Frustration at the high and rising cost of professional services is leading companies to rethink how much value large incumbents are really providing.

Half of respondents (50%) say cost is a challenge when working with consultancies, marketing agencies and law firms. For now, large consultancies, agencies and law firms still dominate; only 23% of survey respondents say they currently spend more than a quarter of their budget on small or medium-sized enterprises (SMEs), defined as firms employing fewer than 500 people.

Eighty-two per cent of respondents say that in five years specialised service providers will be more valuable to their business than those with broad offerings.

As repetitive tasks are increasingly performed by machines, multinationals seeking external services support are targeting niche capabilities—particularly skills that are related to manipulating machines or that a machine is not able to replace, such as creativity or local knowledge. Most multinationals surveyed (58%) say specialised capabilities or experience, such as cyber-security, regulatory compliance or content marketing, are already priorities when selecting management consultants, law firms and agencies.

There is untapped potential to make more use of smaller firms and start-ups to achieve better value for money.

The survey shows that 72% of multinationals expect SME providers to play an important role in their business five years from now. Half of executives say they would hire SMEs over large firms if they could strengthen their value proposition. Multinationals can have considerable bargaining power over small firms.

Too many companies may be relying on old ways to find new talent.

Identifying and evaluating new types of service providers appears to be a challenge that multinationals have yet to fully embrace. Nearly half of respondents (49%) say they are still primarily sourcing external providers using industry directories and events, and 16% say searching online is their main way of finding external help.

US firms are most eager to make use of talent in small firms.

US-based multinationals felt the strongest about the potential for SMEs to play a greater role as providers for their organisation five years from now, but they were also the most reliant on existing industry directories to find partners. As a result, they are likely to be overlooking smaller, less well-known firms, including some with emerging digital capabilities that are hard to categorise.

Companies largely ignore their procurement departments when sourcing professional services, but they may be sidelining a potential resource.

Only 12% of respondents prioritise approval by procurement when selecting external providers. As professional services play a growing strategic role in the innovation of business models, this may need to change.

Executive summary

ABOUT THE SURVEY

In October-November 2017 we conducted a survey of 307 senior executives from companies headquartered in the US, UK and continental Europe, with annual revenue of at least US\$1bn. All respondents were director-level or above, and were responsible for managing professional service-provider relationships in three categories: legal and compliance, marketing, and management consulting.

According to the Professional Services Market Global Report 2017, a study produced annually by The Business Research Company, marketing, consulting (which is broadly defined to include design and research work) and legal services accounted for 88% of the global professional services market.

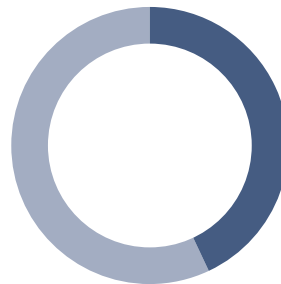


Which of the following best describes your title?

% of respondents

Director or other senior executive

57%



C-suite

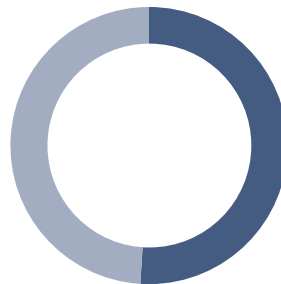
43%

Annual global revenue

% of respondents

More than US\$10bn

49%



US\$1bn to less than US\$10bn

51%

Acknowledgements

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Andrea Castronovo, former vice-president of sales strategy and future retail, BMW

Elizabeth Door, senior vice-president, global strategic sourcing, Whirlpool

Dan Durn, chief financial officer, Applied Materials

Michael Ellis, group general counsel, Abercrombie & Kent

John Gallagher, vice-president of performance marketing, IBM

Natalia Levina, professor, Stern School of Business, New York University

David Roman, vice-president, strategy, Baxter

Mari Sako, professor of management studies, Said Business School, University of Oxford

Monika Schulze, global head of marketing, Zurich Insurance

Nuno Teles, chief marketing officer, Heineken USA

Maria Varsellona, chief legal officer, Nokia

Liz Walker, general counsel, BT Global Services.

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1 Is bigger going to mean better?

Professional services are being significantly affected by new technologies, new service delivery models and new, smaller challengers. Today's dominant law firms, management consultancies and marketing agencies have reacted to a competitive global marketplace with aggressive consolidation.

Law firms in the US and UK have been engaged in a race for market share, particularly since 2013, which is far from over. The consulting and marketing industries are much further ahead in their consolidation. The top ten consulting firms accounted for 56% of the global

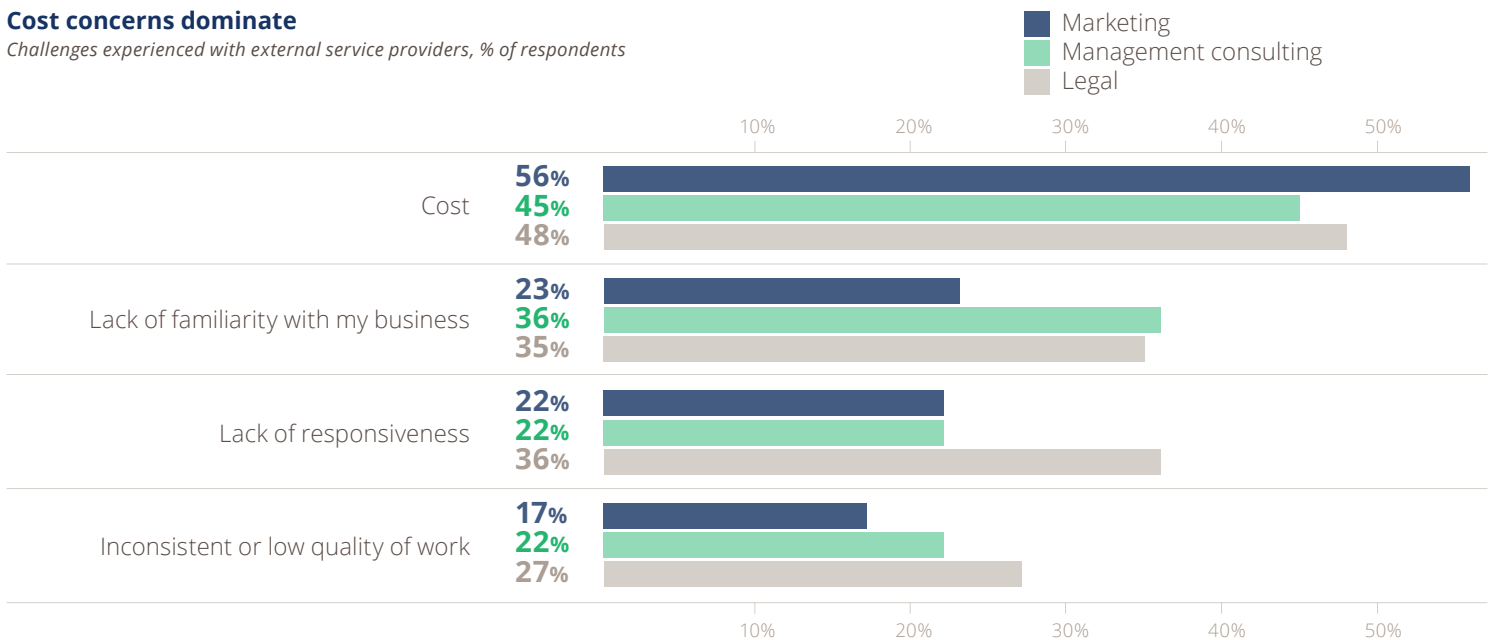
market in 2016, up from 52% in 2014, according to Gartner data. Marketing agencies have long been dominated by four companies: WPP, Publicis, Omnicom and Interpublic Group.

Consolidation may help the leading professional service firms to shore up profit margins, but whether it leads to the best value for their clients is moot. In one sense, scaling up is about tipping the client-provider power balance. Billing rates have increased for technical, analytics, project management and public relations work, and large New York ad firms are charging US\$775-849 per hour for top talent, according to a report from the American Association of Advertising Agencies. The survey shows that frustration at high fees is a common complaint among multinational clients.



Cost concerns dominate

Challenges experienced with external service providers, % of respondents



Inertia abounds, but so does frustration

Multinationals still mainly rely on large consultancies, agencies and law firms—only 23% of survey respondents say they spend more than a quarter of their budget on SMEs. This is a precarious situation though. Cost is the most frequently cited challenge that executives encounter when working with external service providers, cited on average by half of all respondents. Lack of responsiveness and familiarity with the business are the next most cited challenges. The global presence of large service providers does not seem to be a deciding factor. More than a third of respondents (38%) say their consultants in international

markets lack the right expertise. Though spending on professional services is expected to rise in the next five years, many firms are rethinking how to get better value for their money.

The disaggregation of services

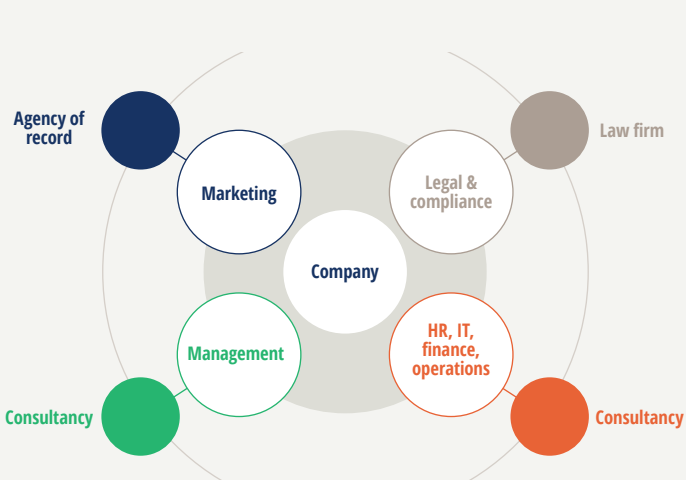
Dissatisfaction with the quality and relevance of expensive services will probably accelerate what academics say is the “disaggregation of services”, when companies break down business processes into discrete steps to improve efficiency. Mari Sako, professor of management studies at the University of Oxford’s Said Business School, likens this to what happened to the manufacturing sector in the 19th and 20th centuries.

Production was divided into a series of tasks that could be outsourced to specialist firms, making today’s complex global supply chains possible.

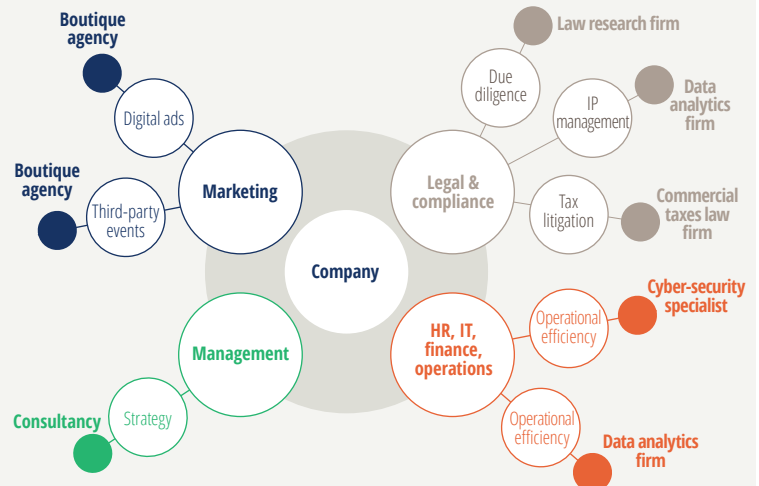
Once a process has been broken down, those in charge can then decide if each step is best performed in-house or by an external provider; and as each task is not as large, a wider array of potential service providers, including smaller firms and individuals, may be able to assist. The key is finding the right talent to do the job, says Dan Durn, chief financial officer of Applied Materials, a global semiconductor manufacturer. “I don’t care about the brand name, I care about the people,” he says.

Unbundling value chains

Professional services could be following in the footsteps of manufacturing. In a traditional procured services model, companies would entrust entire business processes to a handful of vendors. For example, a law firm on retainer would manage most or all of a company’s legal needs, including contract review, due diligence and litigation.



As services are disaggregated, companies break up processes into smaller tasks that can either be performed internally or by an array of service providers at lower cost and with a greater degree of specialisation.



The black box of professional services

The days when law firms, consultancies and agencies could present their services and billing practices as a “black box” are already over. Their clients have been busy poaching top lawyers for their in-house teams and consultants or financial advisers for their strategy and leadership top tables; while marketers have always moved fluidly between internal and external positions. This has given professional business units within multinationals more insight into where real value is added by partners, allowing them to develop a more discerning approach.

David Roman is the vice-president for strategy at Baxter, a US-based medical devices firm. He previously advised Baxter while working for Goldman Sachs and describes Baxter’s approach to engaging consultants as “cost-conscious, but above all dollar-efficient.” A decision

to reassess the use of consultants was made following a recent acquisition, during which Mr Roman’s team were disappointed by the quality of due diligence work received from a large consultancy, which had cost roughly half a million dollars. “They turned up with a 387-page slide deck that I could have prepared by copying slides from our original presentation...It was totally useless,” he says. The lesson was stark: firm size and reputation do not equal quality or value.

To be clear, taking a more discerning approach is not necessarily about spending less—the majority of multinationals surveyed intend either to maintain or increase spending on professional services over the next five years. It is about putting the funds where they will be the most effective. The question on the minds of many executives managing a relationship with an external supplier is changing from

“how can I save money by outsourcing?” to “how can I add most value by working with external partners?”

In a marketplace undergoing rapid digital transformation, this is raising demand for two types of services. First, services applying the latest digital technologies, notably artificial intelligence (AI) and data analysis. These can replace much of the bulk work that might have once been outsourced to cheaper external teams. This frees up resources for the second area, where a great deal of value can be added: specialised services that are not easily replaced by machines, such as those involving creative skills, niche expertise and local knowledge. And if you only need an external service provider to take on a niche task, not a large volume of work, there may be a wider range of service providers, including smaller firms, from which to choose.



2 Going niche

As companies break down projects into more specific tasks and apply digital solutions, they will be looking for different kinds of external support than in the past and will need to re-evaluate the value proposition of incumbent consultants, agencies and law firms.

Indeed, 82% of respondents expect that five years from now, specialised providers will be more valuable to their business than providers with a broad range of offerings. In some cases, specialist capabilities may reduce costs. However, competitiveness is also about staying ahead of rivals in terms of speed, consistency, quality and innovation, and this is where a company's external service providers can play a crucial role, by shoring up knowledge gaps and adding new capabilities.

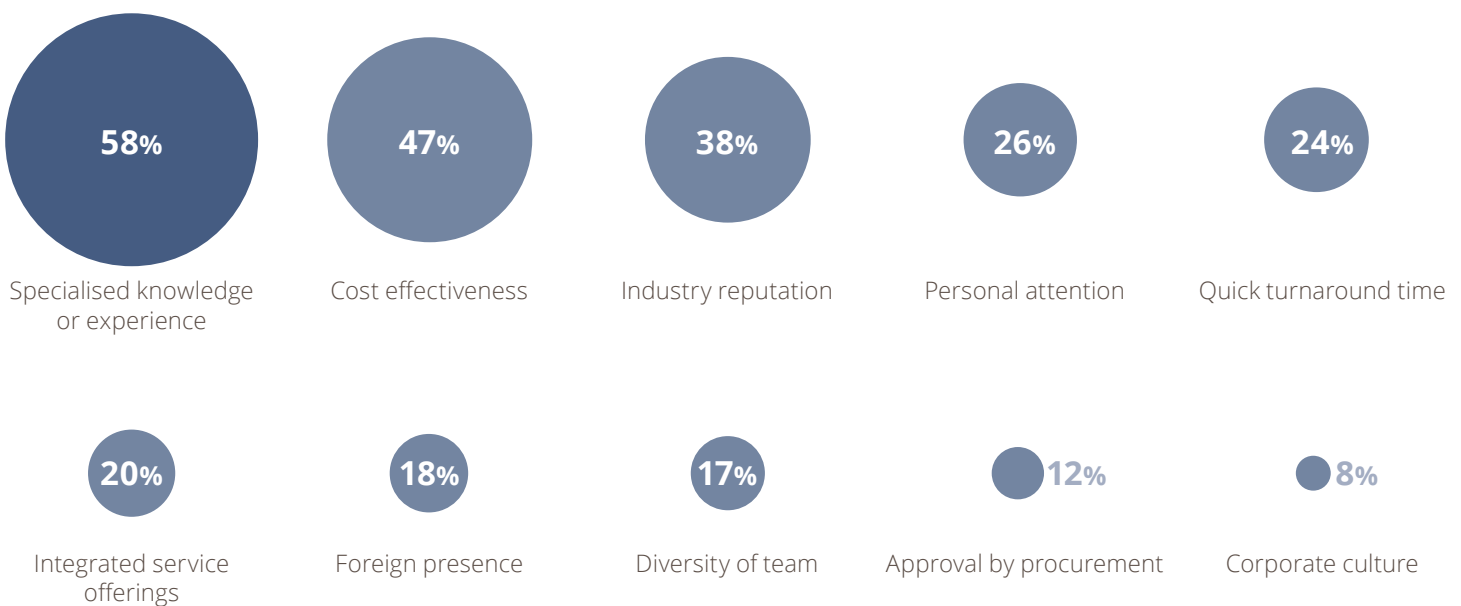
Most executives surveyed (58%) say specialised capabilities and experience are priorities when deciding on an external service provider, with lawyers, marketers and strategy executives all placing this above cost as a factor.

Firms in continental Europe are most focused on accessing specialist skills, with 60% of respondents from this region citing this as a priority factor when choosing a professional service provider, compared with just 37% citing cost. Compared with their peers in the UK and US, these European firms are less likely to be using external firms simply to drive down costs, and more likely to be seeking out firms that can add value to their business.

Wanted: specialisation

Priorities when selecting external service providers, % of respondents

Note: respondents selected up to three answers.



Strategy and marketing: a race for digital and creative talent

Digital strategy and data analysis capabilities feature prominently among the most frequently cited services that multinationals say they will need five years from now. The line between management consultancy and digital services is blurring, with 68% of executives wanting more external help from consultants with cyber-security and 52% hoping to make better use of data analytics.

Digital strategy and data analysis are also among the top areas in which marketers expect to have greater demand. In-house teams and their agencies are engaged in a fierce scramble for digital talent with the world's tech giants such as Google and Facebook. Yet creative talent is equally essential to a successful campaign, and the second area in which marketing executives expect to need more external support in the future is creative and content marketing. John Gallagher, vice-president of performance marketing at IBM, says that where smaller marketing service providers used to mainly derive their competitive edge from strengths in design and creativity, it is now equally important to have skills in data- and technology-enabled marketing. The industry is evolving at such a quick pace that the marketing expert of 2017 may no longer be the top talent of 2018.

Legal: seeking local guides to the regulatory maze

Demand from multinationals for legal services will be sustained by rising regulatory complexity, an area in which just over half of respondents (51%) anticipate needing more outside support in five years. In many cases, local firms may provide better legal advice than

a global firm with no presence in the community, says Michael Ellis, group general counsel at Abercrombie & Kent, a luxury travel company based in London. Mr Ellis says that if his company is making a local acquisition, or needs to review a contract or secure a licence in a remote city, he seeks small firms or independent lawyers to handle the work.

Looking further into the future, Ms Sako of the University of Oxford says that labour-intensive legal tasks suitable for offshoring could well be done using automated systems, enabling in-house teams to handle them with some degree of technical support. Contract and document review would fall into this category. This will push demand for external human support further into the higher-skilled, higher value-added end of legal services.

Labour arbitrage is fading

In contrast to the rising demand for specialists, purely cost-driven outsourcing is declining as a result of economic and technological trends. Cost efficiency will always be an important consideration, but technological tools—from AI to machine learning—are rapidly replacing labour arbitrage as a means of gaining efficiencies.

Liz Walker, general counsel of BT Global Services, a UK-based telecoms company, was involved in overseeing BT's first offshore legal service in the 1990s and has seen BT's reasons for outsourcing shift in the decades since. Not only have shrinking wage differentials between advanced and developing markets reduced the appeal of labour arbitrage, but her firm has also come to see a broader range of benefits from working with external partners. These include the ability to

work continuously across time zones, speeding up deals; taking advantage of partners' knowledge of local regulations, language and culture; and, importantly, accessing new technologies.

Where offshore alternative legal service providers once merely did the grunt work for less, they have become crucial to global delivery models and innovation.

Future needs

The three most frequently cited areas where respondents expect to need external support in five years

Legal

- 1  Regulatory compliance
- 2  Contracts review
- 3  Trademark and patents registration

Marketing

- 1  Digital strategy
- 2  Creative and content marketing
- 3  Advertising

Advisory

- 1  Cyber-security
- 2  Data analytics
- 3  Business sales improvement

3 Bringing alternative partners into the mix

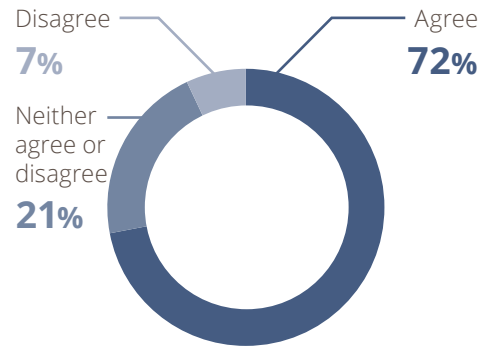
The survey shows that most multinationals have noticed the potential of smaller service providers, but are slow to capitalise on it.

Nearly three-quarters of executives (72%) say they agree with the statement that SME providers will play an important role in their business five years from now, with a third saying they “strongly agree”. There is high-level recognition of the potential value of SMEs: 43% of those who agreed were C-suite executives.

Yet today a clear majority of spending on professional services across the board goes to large organisations. Just 6% of respondents say their companies spend a majority of their budget on SMEs and 23% spend over a quarter, though those based in continental Europe (who are also more focused on accessing specialist skills) make greater use of small firms than their peers in the US and UK. Firms in the UK are still most reliant on large service providers. This may be less a problem of availability than a case of inertia combined with poor visibility of smaller firms.

SME service providers will have an important role in my company five years from now

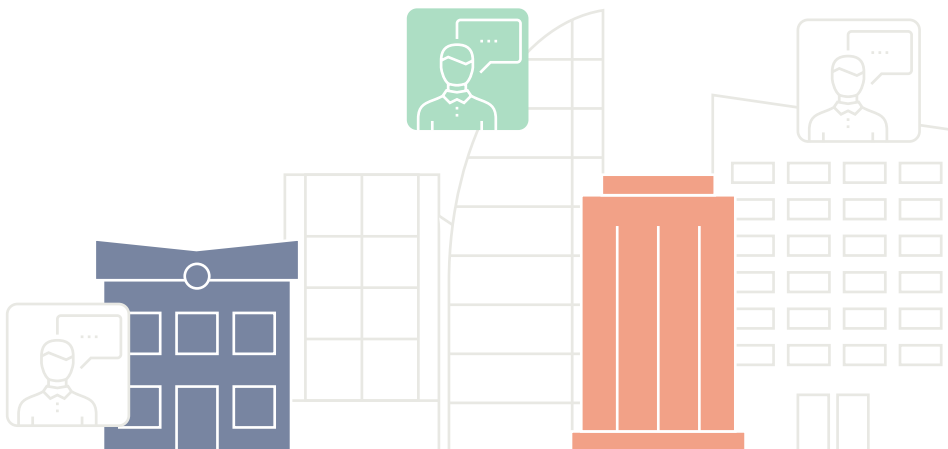
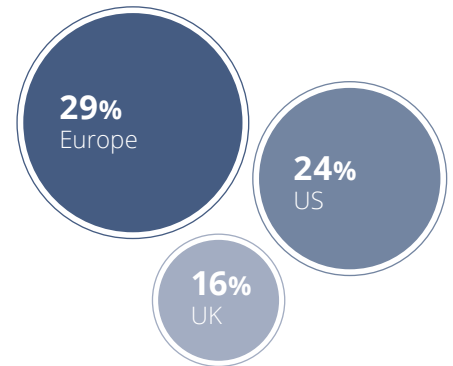
% of respondents



“ Just 6% of respondents say their companies spend a majority of their budget on SMEs and 23% spend over a quarter. ”

Small scale

Spending on SME external service providers exceeds 25% of annual budget
% of respondents



Making the leap to new providers

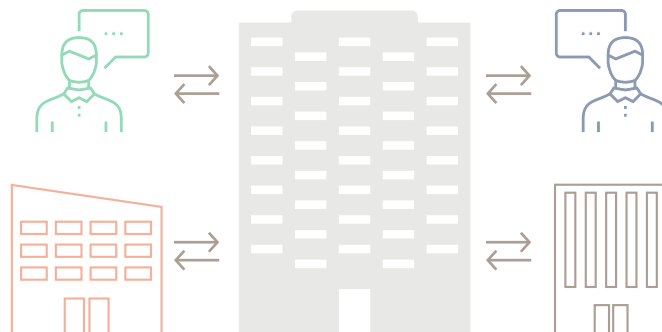
In marketing, some executives are reconsidering their relationships with agencies of record (AORs) and looking into alternatives such as boutique agencies and individual contributors. More than half (56%) of marketers surveyed say they will not be continuing in a pre-existing relationship with an AOR in the coming year. Of these, two-thirds (66%) intend to include SMEs in their mix of external providers and about a third (34%) intend to include individuals, while just 23% intend to work with large agencies.

For marketers, finding cost-effective providers with specialised capabilities is a particularly high priority. Compared with executives in other business areas, the marketers surveyed more often cite cost as a challenge, and lower costs is the most frequently cited factor when choosing between an SME and a large agency.

Poor visibility?

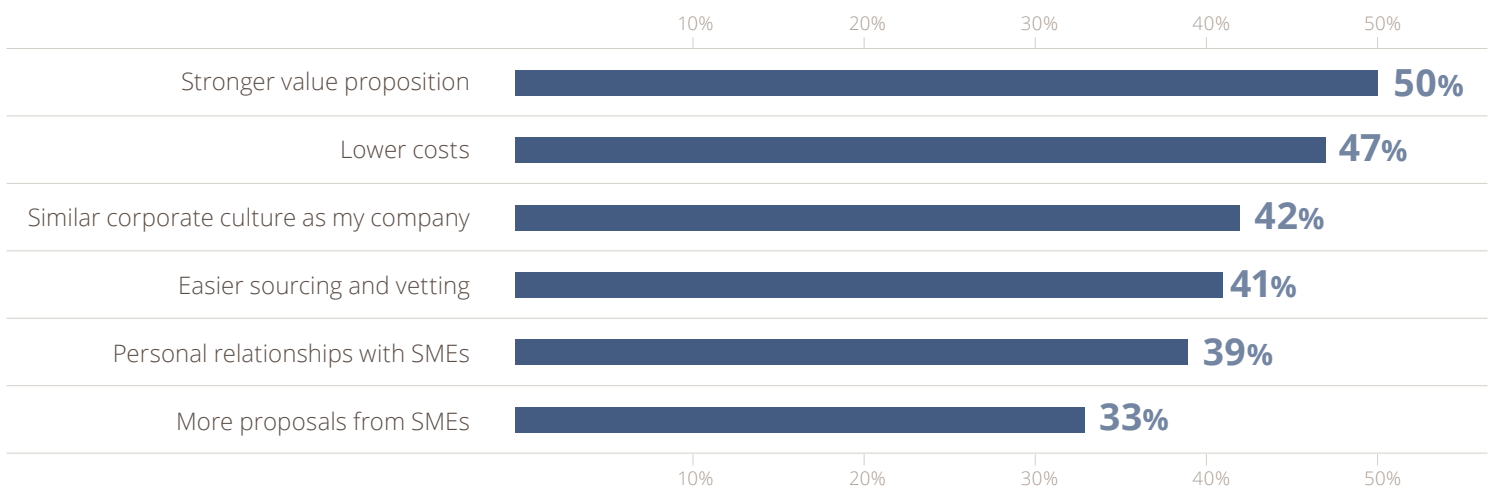
A strong reason why companies are slow to look beyond their incumbent marketing agencies, consultants and law firms is poor visibility of the range of smaller service providers available, and of the expertise they can offer. Some multinationals have been working with their consultants, agencies and law firms for decades and have developed an understanding of where their strengths lie, as well as relationships with specific people within them. The importance of established links and comfortable relationships should not be downplayed.

Forty-two percent of executives say if they could find SMEs with a similar corporate culture, they would hire them over a large company. However, at the current pace that digital transformation is adding competitive pressure on companies, the search for value will inevitably lead many companies to break with the familiar. Half of executives surveyed (50%) say that they would hire more SMEs if they could prove their value proposition was stronger than that of a large firm.



Considering alternatives

Factors that would lead to choosing an SME over a large service provider in the next year, % of respondents



4 Finding what you need when you need it

Too many companies are relying on old ways to find new talent. Even as digital technologies disrupt and transform services, many respondents say they are still primarily using industry directories (29%) and events (19%), which are traditional methods.

Relying on these methods may result in overlooking many smaller firms and individuals as well as emerging types of service providers that defy easy categorisation.

Finding the right provider using traditional methods is not always a speedy process: 29% of respondents say it takes four months or longer to source an external consultant, agency or law firm. US-based multinationals, which are the most reliant on industry directories to find partners, face the lengthiest procurement

process. Nearly a third of US-based firms (32%) say it typically takes more than three months, compared with 24% of UK-based firms. US firms also struggle most with finding smaller providers. Forty-six per cent of executives in the US say that easier sourcing and vetting would encourage them to work more with SMEs, compared with just 35% of executives in continental Europe.

The digital age allows for the use of more active and targeted approaches to sourcing, and should be able to speed up the procurement process. There is some inertia to overcome on this front, too.

Trust can be built, risk must be managed

Executives sourcing specialist services are probably wary of unknown entities. According to Ms Sako, the lack of a proven track record is a particularly high barrier in professional services, compared with sectors in which a standardised product or service can be demonstrated. An obvious way to seek reassurance on this front is to ask for referrals, but this is a method preferred by just 10% of survey respondents.

Personal contacts and multinationals' own alumni networks will undoubtedly be important resources as firms look for smaller, more niche providers. But this approach has limitations in terms of suppressing free and fair competition among smaller players, and limiting the scope of potential talent and experience to which multinationals have access.

Executives will need to find ways to broaden the search while managing risk. It is important to keep an open mind and avoid excessive risk-aversion. Nobody likes cold-callers, but Natalia Levina, professor of information systems at New York University's Stern School of Business, has found that, like it or not, keeping the door open to pitches from new niche service providers can be a key part of the innovation process.

"Without sometimes investing resources into experiments that fail, we would never learn," says Ms Levina. "If a pitch comes from a start-up or smaller company, the larger client has tremendous power to negotiate a deal structure that helps them to deal with long-term risks."

A greater role for procurement?

Multinationals could also make more use of the procurement function, an under-tapped resource for finding professional service providers. Business units have traditionally sourced their own services and have tended to resist the influence of the central procurement function, often out of a legitimate concern that bureaucracy will impede them from sourcing what they really need. This perspective is reflected in the survey, which shows that very few executives (12%) view approval by procurement as a priority when selecting an external service provider. However, it's worth asking whether procurement functions can add more value to their organisations by adopting a strategic role in helping to manage change in professional services providers.

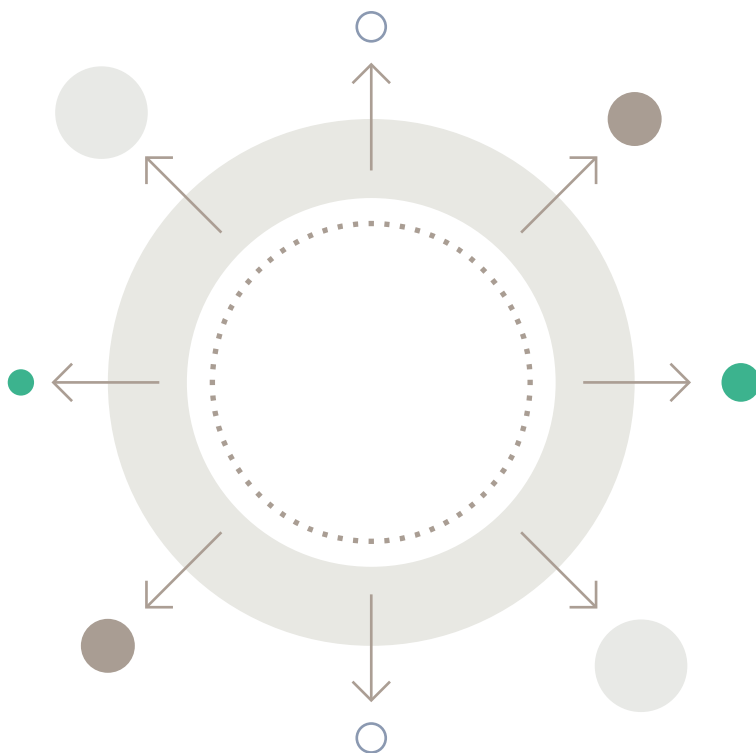
Given how fast some professional services are being disrupted by technologies, other business units may benefit from soliciting the assistance of central procurement. Elizabeth Door, senior vice-president of global strategic sourcing at Whirlpool, a Michigan-based home appliance manufacturer, sends procurement professionals out to events targeting corporate functions such as marketing, in order to help other areas of the business keep on top of emerging trends and potential providers. This puts an onus on procurement professionals to better understand the business units they are supporting, but when it works well it can represent a valuable resource.

There is also likely to be a greater role for procurement in managing the professional services supplier base as it becomes more complex. Working with a more diverse range of providers presents new challenges, from avoiding duplication

to compliance and risk assessment. Incorporating smart technologies into manufactured goods and service delivery processes likewise creates new sourcing challenges. The Internet of Things, for instance, is creating a need for traditional manufacturers to team up with advanced technology service providers, often in multi-stakeholder partnerships. For this type of complex initiative, central procurement teams have an important responsibility to define roles and responsibilities, and ensuring clear governance, according to Ms Door. "We need to create an ecosystem where things can work together seamlessly," she says.

Get smart

Executives wanting to gain the maximum value from their relationships with professional service firms need to become more discerning: first, in which tasks to seek external help with; and, second, in their choice of firms. The age of high reliance on the one-stop-shop law firm, consultancy or agency is being brought to an end by a nexus of rising costs for incumbent providers, new value-creation opportunities, and the emergence of a universe of alternative service providers—many of the alumni and spin-offs of market-leading firms, or former cheap outsourcing partners who have evolved. A wealth of specialist capabilities and new service delivery models are there for the picking but can be hard to find using traditional methods. Smart executives will get a jump on the competition by taking a more active approach to finding the best-value talent. ■



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