FACTORS AFFECTING THE DEVELOPMENT OF PROFESSIONAL FIRMS IN THE U.K.

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Introduction

This paper attempts to examine some of the factors that have been affecting the basic organisation of consulting practices in the U.K. The professional bodies' statistics show that around 720 actuaries are engaged in consulting practice. The size of the firms is varied, ranging from sole practitioners to firms with more than one hundred actuaries. However, when this paper looks at aspects of consulting practice, it takes a broader view than merely actuarial firms. Similar forces have been impacting on professional practices generally in the U.K. and, since the actuarial profession is a relatively small one, it has seemed sensible to draw on a wider experience.

Partnerships and Companies

In 1964, the Court of Appeal of England and Wales decided that a firm of advertising agents were not entitled to compensation from bankers who had given a financial reference, qualified by a disclaimer, in respect of a customer who later failed. The decision was confirmed by the House of Lords. The significance of the case, Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd., lay for the professions not in the outcome but in the principles enunciated in reaching the decision. A party (such as an expert or professional adviser) making a statement (e.g. an opinion) would be liable to compensate "his neighbour" (virtually anyone and certainly the ultimate user or

consumer of the statement) for a financial loss arising from negligence in making the statement. Certain conditions had to be satisfied, notably that the party making the statement could normally be relied upon, knew the statement would be relied upon, and had not disclaimed responsibility. That principle destroyed the notion that a professional person's duty was limited to his client, the party with whom he had "privity of contract". Contrary to earlier thinking, an employed professional practitioner had as much legal liability to his employer's clients as the sole practitioner or the practitioner in partnership.

The point was refined in further legal cases and was well established when the Monopolies Commission reported in 1970 on "The General Effect on the Public Interest of Certain Restrictive Practices so far as they prevail in relation to the Supply of Professional Services". The Commission was very respectful to learned professions, accepting (unlike many onlookers) that they were more than highly restrictive organisations of providers of specialist services.

Even so, the Commission were very critical of the restrictions they found, especially of the form of entity in which practice was permitted. They pointed out how few were the legal constraints on practising as companies. Auditors were the only people of significance not allowed to as a matter of law. Solicitors, architects, veterinary surgeons and dentists could form companies but only if liability was unlimited. Waspishly, the Commission pointed out that this was, to some extent, a hangover of the codification of professional practices prior to the Companies Act 1862, a time when to limit liability was regarded with suspicion!

For the most part, restrictions on practising through companies were based on codes of conduct adopted by the professions themselves. For example, the Institute of Actuaries' Code of Conduct said "The formation of a limited liability company to undertake professional work would be objectionable ....".

Following the report, the Institute's Code was progressively liberalised over the years 1971-72. It became possible for employed actuaries to advise their employers' clients. However, under the Restrictive Trade Practices Act, 1976, a Government agency known as the Office of Fair Trading was authorised to involve itself with the professions and require codes of conduct to be filed with it. This Office has the object of eliminating restraints on competition that are not enshrined in law and does so by negotiation or, in the last resort, by reference to the Restrictive Practices Court. The actuarial profession came under scrutiny relatively early and the problems seen by the Office in the Institute's Code of Conduct were resolved by negotiation. In 1985, the actuarial profession in the U.K. promulgated one of the most liberal professional codes of conduct in the country, and employed and self-employed actuaries in consultancy were put on an equal footing.

Apart from one substantial partnership selling its business to a corporate consultancy, there has been little change to the partnership scene in the U.K. The opportunity to practise in corporate form has been taken up in the main by three types of business. The first is indigenous companies trading as pension consultants. From 1972 they developed their actuarial services and, in parallel developments, changed the composition of their business. Still very much tied to employee benefits,

especially retirement benefits, their actuarial operations were narrower than those of the larger partnerships, who provided actuarial advice in many different areas. The strength of the pension consultancies was in providing most of the services needed to enable an employer to have his own employee benefit scheme.

The second type of entrant was a number of substantial American businesses that created or bought British businesses either as subsidiaries or associates. Generally speaking, the range of their actuarial services falls between that of the partnerships and the pension consultants but with a concentration on consultancy.

The third type of business, and the most recent to get under way, is the substantial and international accounting firms who have been providing consulting actuarial services as part of their portfolio of financial advisory services overseas. Using subsidiary companies that to the general public are barely distinguishable from the accounting firm, they are replicating in the U.K. the sort of operations they have overseas.

In all three of these areas, there are now firms with very substantial actuarial operations.

Thus the result has been a much larger number of firms operating in the market for actuarial services, with mixes of services that differ substantially from one type of organisation to another, and with very different organisational backgrounds.

Competition between the various firms is probably most intense in the area of employee benefit arrangements. None confine themselves to purely actuarial matters and it is noteworthy that the larger partnerships, in constitution the most actuarial of firms, have directly or through subsidiary companies involved themselves in other aspects of these arrangements, such as administration, trusteeship and communications. Nor is competition confined to firms who provide actuarial services. An appreciable number of the larger legal firms have employee benefit departments and the solicitors in those departments by no means confine themselves to legal matters. They too provide a wide range of consultancy services and, whilst the writer knows of none that employs actuaries or carries out valuations, they are not above discussing funding programmes. The market is therefore now one of a variety of different firms.

Business Growth

"One thing has made this profession prosperous - the same thing as has made all the professions prosperous - the Government meddling in things". These words of a venerable actuary were part of the writer's professional induction. The swing of the political pendulum between left and right and the ever-changing kaleidoscope of the business world have produced a constant stream of threats but also of opportunities for those sensitive enough to take advantage of them. Superimpose on that the propensity for successive governments, their agencies and the Courts to give the profession more to do and more responsibilities, and the results for business have been rapid growth and also greater complexity. Taking as an example employee benefit arrangements, there was a huge

expansion in such arrangements over the period 1955-1980, from which the consulting actuary benefited. That expansion may now have ended and may even be in decline, but greater regulation of that business has meant more demand for the expert help that actuaries provide.

The development of business opportunities has not stemmed simply from the greater regulation of familiar fields where consulting actuaries have for long found substantial volumes of business. Not so many years ago life offices needed the services of a consulting actuary only if they were new or very small. Otherwise life offices relied on their internal actuaries. Today a substantial number of consulting actuaries gain their livelihood by advising the larger and older life offices.

Similarly disputes on actuarial matters rarely went to litigation but, today, it is commonplace for the process of litigation to be at least started even if the majority of cases are settled before they are heard in Court.

For years the British actuary has been struggling to persuade the judiciary to catch up on their counterparts in other countries and readily take account of actuarial evidence in cases involving the assessment of personal damages. The prospects of success are becoming brighter and that will no doubt increase the number of actuaries who work in this area. In addition, Scotland has had for a few years laws relating to divorce settlements which point the way to actuaries assisting the Court, something that is quite familiar overseas. There is confidence that sooner or later some similar measure must be introduced in England and Wales, again stimulating the scope for actuaries to be involved in Court work.

One result has been that larger firms have become increasingly departmentalised. The day of the general purpose consultant, dealing with a life office today, retirement scheme tomorrow, and investment matters the day after, has gone. Smaller firms, and some not so small, will tend to specialise - niche players rather than providing the full range of consultancy services.

Departmentalisation comes readily to the consulting actuary who practices through a company. Indeed, some life offices are developing consultancy services by separating from their actuaries those with the right personal attributes and putting them into a new department. It is also straightforward when the clients of the various company departments are different. However, if the clients can be the same (e.g. a client taking the services of both valuation and investment departments), there is a co-ordination need.

Departmentalisation is, however, in conflict with another trend amongst consulting firms, that of establishing local offices. The incorporated firms of consultants, probably those with actuarial services in relatively few fields, have for a long time favoured local offices and are expanding the number. Partnerships have now also gone down this route. The conflict has been resolved by limiting the range of services provided out of the local offices, with the remainder coming from the centre, although that is not a pattern without difficulties.

Growth, and larger and departmentalised businesses, have also created a need for more by way of service departments, for example, accounting, personnel and training functions. Again, these would be normal in large incorporated firms but have had to be introduced into the partnerships.

The growth of business and the greater competition combined have not led only to the functional side of a firm being considered but also to greater attention to strategic aspects of management. "Selling" is still a dirty word in some circles although every firm tries it in some form or other. "Marketing" is a more refined subject and a number of actuaries, notably in life office, are engaged in it full time. It is merely a formalisation of what many people see as desirable anyway and, although the members of many firms would not be prepared to admit as much, it is something they have been doing quite well for years. There were prohibitions on advertising and, even now, there are restrictions. In addition, specialist sales forces are likely to be found only in certain companies. Despite that, or perhaps because of that, the backroom techniques of marketing (such as identifying one's services) and the external techniques (such as extending the circles of contacts) are all practised, and overriding it all is the considerable consumer orientation that is almost a corollary of a "personal and fiduciary relationship".

Practitioner Support

"I think we have a dictating machine somewhere in Chambers". This comment by a barrister brought home how that profession remains close to the image of a professional practitioner, of a sole trader in a one-to-one relationship with his client and very little by way

of support staff or technology to back him up. Other professions have moved substantially away from that traditional image and some, such as architects and civil engineers, have needed a "factory" to back them up. Large scale data processing and calculation goes with actuarial work as child goes with parent and so they too need the support of a "factory". Unlike other professions, the actuarial profession has not spawned a subsidiary profession such as the doctor's nurse or the architect's technician. There has been talk of having an "actuarial technician" qualification but nothing has come of it.

Time was when data processing and calculation services were labour-intensive and the equipment quite primitive. Technology has played a greater and greater role to a point where the actuarial practitioner probably has his own personal computer with on-line contact with the computers at the heart of the "factory".

Technology needs capital, both for the equipment and to finance the production of purpose-written software. Capital will be more easily raised by a corporate structure, whilst the return on the investment will depend on how intensively the technology is used, which benefits the firm providing each of its services on a large scale.

The trend towards more and more technology, together with the specialist staff that it requires, puts the actuarial practitioner at the mercy of another group of well-rewarded specialists. In turn, that leads to a batch of management problems to be considered.

Practitioner support is not limited to the support the consulting actuary needs in providing his actuarial services. As noted earlier, many firms have always provided a range of services and larger firms that have not have now moved in that direction. The result is a whole complex of different operations, taking one further from the traditional image of the professional person.

Organisation

In these last two sections of the paper, the question considered is how firms have coped with the various situations that have been looked at so far.

A partnership is a collection of individuals, and not a corporate entity. It has a privacy shielded from the outside world and from other partnerships. Generally speaking, it is secretive about its affairs but there is survey material on how partnerships function.

Despite close functional links, an outstanding feature of a partnership is the harsh distinction between partners and employees. One has to look at both separately.

The partnership itself tends to have a loose structure organisationally, as any formality has to be by common consent. The efficiency of the decision-making system depends upon how far other partners are prepared to "let go" of the management of the firm. Management tends to be one of three kinds:

(a) Collective government, suited only to smaller firms, although larger firms might apply it to certain matters, for example, substantial investment.

(b) Government by committees, possibly backed by a lay secretariat (which is very often manned by retired officers from the armed forces).

(c) Agreement by the partners on the appointment of a managing partner to whom the other partners will allow autocratic powers. A managing partner is very likely to be backed by a lay secretariat.

The last form of organisation comes closest to mimicking the incorporated firm.

Below partnership level, there will be professional staff, probably aspiring to partnership, and support staff (who may be very specialist in certain fields). Generally the professional staff will be fairly amenable to government by the partners, if only to avoid ruling themselves out of the prospect of a partnership.

Support staff are more likely to have the hierarchical organisation found in companies and other organisations. They are likely to be divided into streams corresponding to the professional activity being supported and report through tiers of management. The management of the support staff has the potential for being in a strong position, especially if the partners prefer collective or committee government. In practice, management tends to be weak as those at the top have no hope of progressing to partner level and the people attracted to this managerial role are unlikely to be highly motivated. It is very likely that the support staff will not be direct employees of the partnership but will be employed by a service company, with partners as directors.

Alternatively, there may be several service companies for special purposes, for example providing trusteeship services or communication products. Some of these may even be trading companies rather than service companies. Indeed, it is possible to reach a situation that is very close to an incorporated consultancy except for the fact that the actuarial consultancy services are provided from a partnership which also happens to be the operation that owns the companies. Within such a structure, it is possible to have a stronger management in each of the companies than if the functions were retained in the partnership. Also, using a service company or several companies was financially beneficial to capital formation in days of high rates of personal taxation. Even now, partners can be director-employees of the companies and so accrue to some extent the benefits of being employees without giving up the benefits of also being self-employed.

There is even more variety to be found in the organisation of incorporated firms. Some are employee-owned and controlled. Others, such as those attached to accountancy firms, will be at least the part subsidiary of a partnership. There can be a private company externally owned, a subsidiary of a U.K. trading company or group, or the subsidiary of an overseas body.

In some of these firms, the practitioners can act and think just as they would in a partnership. At the other extreme, a company may be subject to the full rigours of modern management controls applied to companies, possibly imposed from outside. There is then a danger of a structure being imposed that is unsuited to actuarial practice, perhaps through a lack of understanding of professional practice or perhaps through making erroneous presumptions about professional practice.

The distinction has been analysed as a question of 'who does most for the business, the line manager or the specialist manager?'. With the production of some services, just as with the production of goods, they are produced by the factory, by the "works" or "shop-floor" employees. It is the line managers who manage that who do most to decide whether the company is successful or not. Any specialist managers who have a role by virtue of their expertise are peripheral. The company whose business is providing professional services, such as those of the actuary, is institutionalising that profession's knowledge, and sustaining its creation. The "shop-floor" is in a supporting role. Thus the importance of the line manager and the specialist manager are reversed. In such an operation, hierarchical responsibility cannot extend to the professional services being provided by the appropriately qualified person. Ideally, the hierarchy will be wide and flat, the opposite to the steep and narrow hierarchical organisation of a bureaucratic company.

With company consulting actuaries organized in a wide, flat organisation, the actuarial services company comes as close as it can to a partnership. Organisation will, however, diverge when it comes to providing a range of services for one client. As noted above, the support groups providing those other services are likely to be organised in one or more companies subordinate to the partnership. With a company, they are likely to be organised as other services parallel to actuarial services and reporting through a common hierarchy of management. With a partnership, it is likely to fall to the partner to co-ordinate the groups providing specialist services for a client. With a company, the

lead consultant most in contact with a client may or may not be an actuary, and he is likely to see himself as co-ordinating the provision of services, of which actuarial will be simply one.

Management Functions

The urge to grow seems universal to consulting firms, remarkably so given the perpetual cry that adequate resources are in short supply. The driving force seems to be the fear that the firm that does not grow will stagnate.

The managerial implications of the pursuit of growth are remarkably similar for all consulting firms, whatever their basic organisational structures.

On research and development, the professions generally have been very good at reacting to externally created opportunities (for example, those created by the government). Those involved in a particular area of practice become so involved in it, and in developments of it, that it needs little perception to see the business opportunities. The professions have also been good at diversifying their practices, for example, a partnership extending the number of areas in which it does business. Sometimes this has been done as a matter of policy, perhaps because the firm is coming to rely too much on one or two areas of business. It may be spurred by the perception of a need on the part of several clients. Sometimes diversification will be deliberate for tactical reasons to meet the competition.

The growth of business available has been discussed earlier. Marketing with growth in mind is directed at obtaining a share of it, by obtaining new clients, by developing more business through existing clients, extending the services provided to each, and by avoiding the loss of clients. The greatest success can be obtained if the firm targets clients, concentrating on those with most potential for business. The other side of the coin of acquiring business is to obtain the resources to handle it. A remarkable generality about professional firms is that they tend to underman, as if there is a lack of confidence in the future. It is unfortunate as professional services are essentially labour intensive and the pressure from the customers is always for a higher level of personal service. Allegations have been made that professional organisations are inefficient users of labour but most, if not all, firms attempt work scheduling in the cause of efficiency and service. The writer has yet to hear of a fully satisfactory system for scheduling the work of actuarial services.

Another common feature is that great efforts are made to create an identification of staff with their firm, and to achieve a sense of community throughout the organisation. The evidence is that partnerships tend to be more lavish over this, a consequence perhaps of the greater gulf that exists between partners and the rest which would not be found in a company. Generally, labour relations legislation is of little consequence and the level of trade union membership is low. This signifies good employee relations but in some quarters there is a lack of confidence that this will continue in relation to the practitioner-support staffs.

Universally, there is great emphasis on the selection and training of professional staff. In some cases, this is against a background that each recruit is seen as potentially a new partner or director, but attitudes differ - some firms are content to sort their high flyers from the low flyers once the staff are onboard and trained. There are more differences to be found in motivating professional staff. One sees general agreement that the better young professionals will respond first to challenging and interesting work. They also take a keen interest in how their professional development as actuaries will be managed, looking at how quickly the level of work, the level of client contact, and the level of client responsibility are raised. When it comes to material rewards and general standing in the firm, then differences emerge. At one extreme, the partnership can hold out the prospect of being a partner. At the other extreme, an externally-owned and controlled company has no corresponding prospect and so has to place greater emphasis on the financial rewards and the perquisites; these may well include a profit-sharing and share-option schemes. Whether the prospect of status in the company hierarchy is significant will depend on whether the management hierarchy is substantially actuarial.

A fear that surfaces from time to time is that the practitioner support, the "factory", will wither. As the work comes to depend more on computer programs, the fear is that clients will buy the programs, take the work in-house, and use the professional person, i.e. the actuary, for advice only. Occasionally that has happened in respect of administering employee benefit arrangements but even there the traffic seems to be the other way.

For purely actuarial work, although the fear has existed for a long time, it seems to be more due to a lack of confidence in the future rather than something borne out by experience.

A greater fear is that, for some reason, perhaps government action, one area of business will wither away very rapidly. Unless there is scope for new business elsewhere, and possibly even if there is such scope, a firm would then be faced with the possibility of making staff redundant. With a company, even consulting actuaries could find themselves in that position, which could not happen to a partner.

A question that confronts most firms is how quickly they can try to grow? How quickly can they acquire new business, how quickly can they acquire the resources to handle it, and how do they manage the growth to keep the business development and the resources in line? Inevitably, one has to take account of a time-lag: the resources have not only to be acquired but also trained before they can handle new business. Also, training requires the diversion of resources that could otherwise be used for servicing business. At the present time, the problem is further complicated by the question of who should be recruited for training, bearing in mind the rapid decline in the number of young people coming into the labour market each year.

In some businesses, financial management is the supreme management control. That is probably not so with consulting firms, although it is difficult to obtain details of how different firms operate, particularly partnerships.

It is possible for a consulting firm to budget almost entirely in terms of staff time. In some partnerships, it might be easier to get time budgets agreed than financial budgets. Depending on the category of partner or staff, the budget would provide for so much time on chargeable client services, so much on managing the practice, so much on training, so much on increasing the firm's standing etc. The income budget will then derive from the budget chargeable time and the expenses are likely to be overwhelmingly staff-related costs.

Admittedly, capital expenditure could not be dealt with in this way and would probably require tighter control. In a partnership, it may need the consent of all the partners.

At another extreme, an incorporated consulting firm might find itself with an externally-imposed management accounting system, including a reporting system. There would be company, departmental and individual income targets and detailed expenditure budgets which would be regularly monitored. Similarly, there would be detailed arrangements regarding capital expenditure, with certain items being reserved to top management only and limited authority to other directors and managers. Whether the income and expenditure budgets make sense in relation to the personnel and the time they have available would be left to the individual managers and practitioners to consider.

In between these two extremes is a range of possibilities. Clearly the implications for both the allocation of time and for income and expenditure have to be considered. The differences between firms comes in the level of management at which the comparison of the two aspects is made.

Conclusion

The major employers of actuaries in the United Kingdom are life offices followed by consulting practice. Both have seen radical changes in the environment in which they operate over the last few years. Even so, it has always been consulting practice that has given the appearance of being the less confident sector, a perverse attitude when employment in that sector has grown so much more rapidly. It is also the more private sector when it comes to management and organisation and information has to be gleaned from personal experience, survey material and a search of literature.

What is clear is the exceptional diversity in the forms of organisation, a diversity which stems from the different origins of the firms now in consulting practice. The form of organisation most suited to modern consulting practice has not come to the fore at all. This raises three questions:

(i) Can such diversity be perpetuated?

(ii) If not, what form of organisation is going to come out on top?

(iii) Is there experience elsewhere that will give some pointers to the answers?