GUEST SPEAKERS

Mega-firms and giants: The new landscape of large-firm practice

Are organic and group organizational models obsolete and at a disadvantage?

The landscape of large-firm practice is changing. Consolidation and growth through merger and acquisitions (M&A) has crowded the large architecture-engineering (A/E) category and brought new mega-firms into prominence. Despite the press coverage the mega-firms have received, they and other large firms in the A/E sector still adhere to three organizational models:

- Organic: Single-brand A/E firms that only grow organically
- M&A: Single-brand A/E firms that also grow through M&A
- Group: Stable-of-brands holding companies that grow through M&A

Clearly, M&A is getting the headlines. The emergence of mega-firms, with tens of thousands of employees, has left existing A/E "giants" looking small. At the same time, those giants are facing new competition from formerly smaller firms that have used M&A to bulk-up quickly.

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Does the emergence of M&A-driven mega-firms mean that the organic and group organizational models are obsolete? Does the new competitive landscape put them at a disadvantage? To answer these questions, let's consider what each organizational model offers the A/E sector's principal stakeholders—A/E firm owners, their employees, and, most important, their clients.

The owner perspective. All three models let owners increase market share and penetration by adding services, practices, and locations. M&A can speed this process by letting firms buy the established brand value, order books, talent, and market access of the firms they acquire. All three provide opportunities to cross-sell services and leverage scale to reduce transaction costs. Many M&A and group firms are public companies that answer to shareholders, and their ability to continue growing revenues and profits is crucial to maintain or increase their market value.

For the targets of M&A and group firms, the attractions of being acquired can range from pure survival to the chance to achieve goals and ambitions faster than if they remain independent. The current discrepancy between domestic and offshore markets for many firms makes the possibility of immediate offshore growth appealing, especially if the downturn makes the cost of entry into those new markets prohibitive. Absorbing them into the larger brand is also easier if the acquired firm understands that its brand has less meaning outside its current markets.

Groups often make a specialty of acquiring prominent firms, sorting out their financial or transition problems, and relaunching them under their current brand names. These stable-of-brand firms may act simply as holding companies or they may seek to add value by providing a common administrative platform and encouraging cross-selling and the sharing of resources.

In both cases, though, the emphasis is on leveraging the brand value of the acquired firms. This is attractive to those firms' owners, but it may make it harder to create synergy across the group.

The main risk for M&A firms is in the post-merger management of the acquired companies. The successful ones take care to incentivize newly acquired employees, particularly one level down from senior leadership, to shift their loyalty and productivity to the new firm. They also take pains to maintain the acquired firm's relationships with clients, partners, and communities.

Both external and internal communications are crucial to "sell" the merger of the acquiring and acquired firms to their various constituencies. Even groups that preserve the names and brands of their acquired firms have to reintroduce them in ways that underscore the positives. If a stable-of-brands group transitions to a single-brand M&A firm, it has to establish its identity and reputation anew. Part of the argument for doing so is that single brands are easier for public shareholders to understand than a stable of brands.

This is the idea behind Richard Branson's Virgin Group, for example—the group is focused on managing the brand and making sure the largely autonomous business units hit their targets for brand fit and financial performance. Yet, Martin Sorrell's WPP is a counter-example— it has rationalized the operations, including real estate, of its brands portfolio to increase their sales and profits while maintaining their separate brand identities and creative autonomy.

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Both are potential benchmarks for the A/E sector.

Why do some A/E firm owners prefer organic growth? They often stress the virtues of a strong culture, believing that integration is hard enough without the added burden of M&A. Another motive is the desire to perpetuate their independence. Firms with strong brands and cultures have some built-in advantages, as we'll see. Maintaining them is probably their greatest challenge.

The employee viewpoint. A/E firms attract employees for a variety of reasons. Whatever the draw, the firm has to provide it continuously or it will lose its best employees to others who can do so more reliably. Organic firms may have the edge in forming strong cultures in which people are closely aligned and therefore able to meet a common standard of quality and performance, for example, or to work effectively with others, despite geographic or disciplinary boundaries. Often, the people in these firms "grow up" in them, absorbing their values. The firm itself becomes a motivating force.

The risk for organic firms with strong cultures is stagnation: change may be resisted as "not us"; an "it ain't broke" mentality can hinder innovation; and an overemphasis on in-house leadership is vulnerable both to economic disruption— slow growth limits opportunities for promotion— and favoritism masking as cultural bias.

Organic firms need top leaders who sometimes cast against type and are willing to reshape their firms for a future that demands different skills and talents. This is also a risk for group and M&A firms, but both answer to outside owners. Organic firms need leaders who can use the alignment of their strong cultures to drive necessary change.

Workforce mobility is an issue for all three types of firms. The social contract of employment is complicated by economic disparities from market to market. Large firms can smooth this out to some extent by sharing work among their offices and mobilizing people where the growth is. They can provide desirable career paths for workers who embrace a mobile lifestyle or facilitate the cross-office integration of project design and delivery. A talent for virtual teaming, in other words, is as valuable as a willingness to get on a plane. For M&A firms, building a strong culture may be less crucial than putting the protocols and processes in place that make it fast, easy, and professionally rewarding for disparate teams to collaborate effectively from different locations.

How clients see it. Large firms make virtues of their size and reach. Clients value both, but with two reservations. The first is integration— is the firm sufficiently knitted together in its pieces and parts to deliver a broad array of services adding value in the process? The second is differentiation— can the firm match the creative talent or specialist knowledge of its smaller competitors?

For global clients, the allure of "one-stop shopping" has to be weighed against the specifics of each assignment. They've found that "integrated" firms in other sectors like advertising can find it challenging to move quickly, pull recently acquired practices and services together, and bring in outside resources when assignments warrant. In the A/E sector, mega-firms and groups both have to prove that size and constant acquisition don't impede their ability to serve their clients.

Groups also have to show that their cross-selling is real and adds value. One strategy they're using is to grow their individual brands, increasing their dominance in existing markets, and to use the group to move into new geographic regions where these "name" brands lack clout.

The independence of organic firms can be an advantage for clients. Former Xerox chief scientist John Seely Brown argues that the ability to mobilize talent and resources is more important today than owning it. Organic firms have less incentive than M&A and group firms to keep all of their services in-house. Their "big Rolodex" gives them access to bespoke talent, while routinely teaming with outside firms hones their skills at collaboration and integration. Their challenge is to focus their activities on the opportunities that make these traits a virtue.

Implications for the future. Successful large firms get that way because they're great at "process" and "mass-customization." They're in their element handling big assignments that smaller firms find a logistical nightmare.

They master integration because projects of this type demand it. So their differentiation usually centers on these qualities, which puts them at a disadvantage in relation to competitors that focus on one-off (bespoke or custom) creativity or on narrow specialties for which they are the experts.

Some of the consolidation that has taken place in the A/E sector has brought regional specialist firms together under one umbrella. The parents— including both M&A firms and groups— are thus able to compete nationally by integrating the acquired firms as national or global specialist practices, better able to leverage talent and a stronger platform of administrative and operational support.

The speed with which they do this is a competitive advantage, getting them to market faster with a credible specialist offering than most organic firms can manage.

The era of mid-size specialist firms with a purely regional focus may be over, although this has often been predicted.

Among the now-diminished A/E giants, the big question is how to position themselves against mega-firms, on the one hand, and bespoke/specialist firms on the other. The average giant faces a horde of competitors at both ends of the size-and-reach spectrum.

Knowing who they are and what they most credibly offer will be crucial to their future growth. In the end, the organizational model matters less than what the firm does with it. Global markets are unavoidable today for large firms, shifting their center of gravity and making collaboration and integration harder.

Clients want seamless and large firms and mega-firms both struggle to provide it. Clients also want talent, and will scour the earth to find it. That rolodex is still important.

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