

The Value of Industry Specialization in Professional Services

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Niche expertise is valuable if built on a sound foundation.

Anyone who has interacted with investment bankers recently has noticed the proliferation of hyper-specialized groups, organized around very specific niches. But it didn't used to be this way. Yesteryear's well-rounded investment banking generalist turned into an industry specialist, who turned into a sector specialist, who now focuses on collecting tombstones in a single niche sub-sector with wide geographic coverage. It isn't just investment bankers, either. We've noticed an increasing level of industry-specificity across professional services providers.

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Strategy consultants, accounting firms, even lenders and lawyers have developed increasingly industry-specific practices over the last twenty years.

Does this hyper-focus result in better outcomes for clients? In other words, does it matter? Frequent Insight readers already know that the answer is "sometimes," for reasons we'll dive into below. But before we do, we should investigate how this evolution came to be.

The Beginnings of Specialization

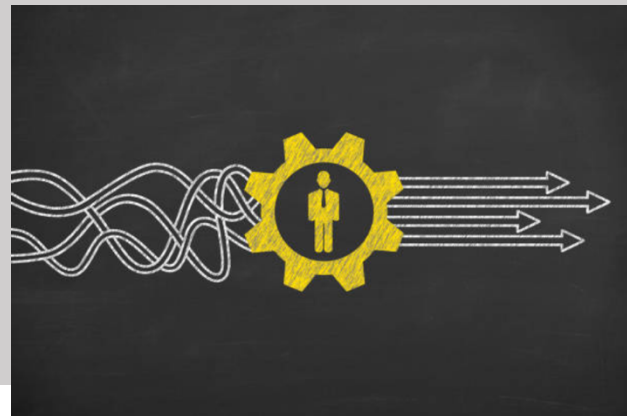
Industry specialization was lightly existent in professional services well into the late 1990s. For investment bankers, expertise was expected to be transaction execution, regardless of the peculiarities of the businesses involved. Lawyers focused on the law, accountants on the accounting, and so on. There were certainly areas of specialization, but they were related to the complexities of the provider's business, not the client's. For instance, an associate at a large law firm might dedicate to an M&A group, an accounting manager might become a transfer pricing expert, and a strategy consultant might start focusing only on pricing strategy. But as far as the

client's business was concerned, getting "up to speed" on an industry and the business itself was just part of the learning curve of the beginning of a project.

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This began to change at the end of the 20th century at the rise of the Internet Age, as a result of a perfect storm: a combination of enormous economic activity, in a very rapidly developing landscape, with complex regulatory frameworks that rendered those on the wrong side of the "learning curve" unable to contribute. Many bulge bracket investment banks reacted to this by formalizing "TMT" – Technology, Media, and Telecommunications – groups in order to focus exclusively on this part of the business landscape.

Investment bankers (as well as others) found that deep specialization in this space wasn't just an advantage, but a requirement for participation. Dedicating time in this particular arena allowed



advisors to be more relevant in their knowledge of the marketplace and its participants, as well as of the quickly shifting regulatory landscape, and could therefore provide better-quality advice.

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The result of this better-quality advice was measurable, in the form of completed transactions and satisfied clients—and it is true that in the absence of this detailed knowledge, the likely outcome was failure.

When Specialization Matters

The above example is a perfect profile for when industry expertise is a true differentiator for an advisor of any kind. If the absence of specific, difficult-to-obtain knowledge would endanger the success of a successful engagement, then such knowledge becomes a fundamental element of an advisor's toolkit. For an investment banker, that knowledge could take the shape of:

Deep technical aspects

In a marketing process, an investment banker needs to be able to articulate the value proposition of the client's business, and if that value proposition is built on the

advantages of specific technical approaches (often with accompanying intellectual property), then the banker needs to understand and appreciate the value of the unique approach. If a banker doesn't know his mass spectrometry from his liquid chromatography, then it's going to be difficult for him to be much help to an analytical chemistry instrumentation manufacturer.

Regulatory barriers

Complex regulations can be decoded by consultants and lawyers, but using that information to inform the economic structure of a deal lands in the lap of the investment banker. You can get pretty far down the road of a transaction involving Alaskan crab quota shares, until you find out that the envisioned deal would put the buyer over his IFQ use cap. Knowing how to navigate the restrictions at the deal structuring stage can mean the difference between a broken deal and a successful close.

Specific buyer behavior

If there are only three viable buyers for a business, and a banker knows each of the buyers' corporate development heads by name and knows exactly how their diligence processes operate in the context of a transaction, then that banker can specifically design a sale process to use that knowledge to the seller's advantage. That kind of knowledge can't be looked up online—it's hard-won from participating in previous transactions with those very individuals.

The Industry Specialization Trap

The trick about deep specialization is that it's only effective if it is an extension of an already robust general skill set. Let's again

make an example out of investment bankers: there are many general skills that have a meaningful impact on the likelihood of a project's success. A banker needs to be able to articulate the specific value proposition of a business to a group of prospective buyers, and manage the bid process and subsequent negotiations in a way that preserves the greatest value for the seller.

The same argument could be made for any other professional services provider: the directly applicable expertise is valuable, yes, but not *as a replacement* for the core skill set.

Most of the skills critical to this process—an understanding of a buyer's perspective on an acquisition process, the ability to obtain and organize necessary information to provide to buyers on a timely basis, the ability to communicate fluidly with all parties in a transaction in their preferred cadences and styles, a sense of when to inevitable transaction impasses—have nothing to do with a client's industry, business model, or marketplace. These are industry-agnostic skills, honed over years of practice and feedback. The same argument could be made for any other professional services provider: the directly applicable expertise is valuable, yes, but not *as a replacement* for the core skill set.

This may be obvious to some, but the challenge for anyone making a decision to *hire* an advisor is that the core skills are very hard to evaluate. Because of that opacity, clients have no choice but to rely on other signals or proxies for that ability.

An easy (albeit imperfect) proxy for investment banking experience is a closed transaction, especially one with recognizable parties, so a business owner therefore tends to look for a banker that has worked with a business identical to his own in the past.

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A banker is more likely to have that specific closed deal if he spends all his time in a very narrow segment of the economic landscape, which brings us full circle back to the original point: the trend in super-specialization in professional services is more of an exercise in signaling to prospective clients than it is a natural



evolution of providing better service. Put simply: much of specialization is about marketing.

As with any other nuanced argument, specialization is not *always* about marketing. Many clients can claim one or more of the attributes discussed earlier in this article, where industry specialization provides true differentiation to the quality of an advisor's work product. Outside of those cases, we find that prior experience

with similar business models and industry dynamics is certainly a nice-to-have, but there are other foundational abilities that should carry more weight. That goes not only for investment bankers, but across the professional services spectrum—for lawyers, accountants, consultants, and others.

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