Firm Strategy and Industry Clusters

by Patrick J. McKenna

Whether your firm chooses to operate in one primary location, spread offices across a regional or national footprint, or even pursue international expansion, your ability to grow in each local business environment is becoming more strategically important than ever. In that regard, I believe it was the renowned futurist John Nasbitt who first said, our challenge is to think global, but act local.

When you think about the various options available for stimulating revenue growth at a local level, one of those options is driven by the preponderance of the various industries that are located in that particular market. However, industry configurations are not the natural way that lawyers are accustomed to thinking about their marketplace.

As we're engaged to work with firms in developing growth strategies, I am inevitably surprised by the lack of knowledge that partners display, in understanding which industries often have a prevailing influence in their particular locale. In fact, in a number of recent meetings of partners (after having done the required homework myself), I've asked these partners to tell me, "What particular industry concentration or "industry cluster"(as it was first termed by The Institute of Strategy and Competitiveness at The Harvard Business School) is your city or region best known for?" A short period of stunned silence is then often punctuated with a few wild guesses and only very infrequently, does someone manage to guess correctly.

What Are Industry Clusters?

If you remember your high school history, you will remember that the very first clusters, such as leather tanning and textiles in Europe, predate the Industrial Revolution by centuries. Today, our economic map of the world is characterized by industry clusters: critical masses in one place of linked industries and institutions--from suppliers to universities to government agencies--that enjoy unusual competitive success in a particular field.

While some of the most well known clusters you would recognize immediately, like the car manufacturers of Detroit, computer makers of Silicon Valley, aircraft manufacturers of Seattle, financial services in New York, and the movie makers of Hollywood; industry clusters are more than a group of companies in the same industry. Industry clusters are actually a geographical proximate group of interconnected companies with associated institutions in a particular specialization – all linked by networks.

While a locality can have an industry group, for example the Napa Valley vineyards, what would make this group a cluster would be the presence of upstream and downstream specialists. Using the example of the Napa Valley vineyards, this would include upstream manufacturers and suppliers of herbicides, pesticides, and irrigation, harvesting and processing equipment – while downstream would include manufacturers and suppliers of winemaking equipment, bottles, labels and corks. The associated institutions would then include government departments (including export), educational and research organizations, plus other related industries like tourism and hospitality.

Furthermore, any parent cluster can then lead to the development of offspring groupings, as the computer equipment manufacturing cluster of Silicon Valley led to the development of a computer software development industry. The hallmark is the combination of competition and cooperation between all the organizations within the cluster. Not only are purchasers communicating to suppliers further refinements they would like, but suppliers are competing with each other to provide greater innovation. The result is a locality where industry participants are all striving for "best practice."

The cluster inevitably becomes important to the local economy and this leads to the strengthening of relationships between companies and local educational institutions. In many instances, those educational institutions are soon designing particular technical and substantive courses, and even qualifications for industry participants.

Individual companies located in a cluster are able to realize a cost structure, due to specialization of suppliers and industry groups, the likes of which could only be achieved by a much larger organization. The measure of success of the cluster is the greater amount of products (goods and services) that are exported out of the region when compared to locations that only have groups of similar industries in a non-cluster. A successful cluster can then drive greater rates of growth when compared to similar companies not in a cluster.

And it is this rate of growth that should make cluster development of particular importance to any law firm looking to target an area of opportunity.

How Clusters Form.

Clusters form around inputs and outputs – where these items involve transportation costs, then locating in close proximity reduces costs. Many older clusters were formed based on this principle. For example, Detroit car manufacturing was based on the proximity to US steel mills plus the availability of cheap electricity.

Clusters can also form around proximity to information. Where companies deal in the same type of knowledge, they can maximize their access to that knowledge base by locating in the same city. Where it might be argued that internet communications would diminish this factor, clusters arise depending on the type of information. For example where knowledge is qualitative (vs. quantitative) and ambiguous, this requires face-to-face communications, which then leads to clustering. This is one of the factors, which despite technological advances, explains why major financial services industries remain concentrated in only a few localities.

Academics first began studying clusters a decade ago. But it has only been more recently, at a time when governments from Washington to Paris to Tokyo are looking for ways to give their economies an edge, that clusters have begun drawing substantial attention and money from policymakers and legislators. Nearly every country, state and region wants to host clean industries, that generate lots of white collar and professional jobs, which add value to that locality. Governments, at all levels, have been looking at these cluster concepts to determine suitable policy initiatives and to offer economic incentives to stimulate development, especially ahead of other regions, they regard as competitors.

Recognizing How Clusters Can Be Important To Your Strategy

It is still staggering to understand why, in spite of two decades of witnessing other professions, like our brethren in the accounting and management consulting fields, focus on seeing client need through an industry lens, that so many law firms still miss this opportunity. It gets even crazier when we consider that one of the primary reasons for corporate counsel to either select (or deselect) any firm is increasingly based on the degree to which that firm clearly understands the client's business, their industry, and what keeps them awake at nights.

Following on my earlier question of what cluster is your city known for, my logical second question to this same group of partners is usually, "Now tell me please, which of your competitors, in this market, has successfully targeted and created an acknowledged reputation for serving this industry group?"

I ask that question, because one of the important aspects of how clusters can impact your firm's strategy is in understanding the principle of "*first mover advantage*." First mover advantage is nothing more than a competitive advantage that can accrue to a particular law firm, by virtue of their being the first to enter and be visibly positioned within a given market.

First mover advantage arises from four primary sources. Where a firm successfully enters into serving a specific industry, and is thereafter perceived by the industry members as having specialized knowledge in their unique business and legal matters, it can develop within that industry a name recognition that becomes hard for others to match.

Second, in any market with a steep learning curve, being first can confer the advantage of having a head start. That head start allows your firm to position itself as a primary source for media commentary, for seminars presenters, for having articles published and other such positioning tactics.

Third, in some situations, key resources are scarce. So for example, the first law firm to become active in a new industry association could lock out others. There is also the ability to develop the first primary relationships with key members of the cluster. Clusters are a magnet for attracting world-class talent, that often then moves between companies within that particular cluster. Thus, when a key player moves from one company to another, or to even start a new venture, that professional who has the personal relationship has the inside track.

Finally, a first mover has the opportunity to draw clients into their web, creating "switching costs" that curtail those clients from any notion of later, moving their work to other fast follower firms.

That said, the structure of the legal profession makes it difficult to protect competitive position forever. The profession often operates in a manner similar to the television industry. Because it is difficult to know in advance which shows will be hits, as soon as one idea looks promising, everyone rushes to pile on. (Witness the number of Survivor and reality-type shows being hosted by every network.)

Similarly, in a recent study of America's 250 largest law firms, more than half, 139 firms, are reported to have started entirely new practice groups in an effort to stimulate growth. I don't know how many of those new practices are focused on areas of opportunity where the firm might be in an unbeatable position to develop a distinctive advantage, but I do suspect that a large number, are an effort to jump on some new perceived bandwagon (like developing a Homeland Security Group) simply because someone saw other firms developing a practice in that area.

Being first in a market is a definite advantage, but only when you do something with it. (See my article: *Develop A "First Mover" Advantage: Effective Strategy Often Requires Being First And Being Exceptional*)

Example of Industry Clusters And How They're Having An Impact.

Wherever you happened to practice, be it a major metropolitan area or even a smaller city, chances are that some industry cluster has grown up in that area. Following from that it is worth examining to what extent your firm has developed experience serving companies in this industry, how fast this industry may be growing, what other opportunities may be available as a direct result of your building some knowledge about this industries particular challenges, and most importantly, whether there is the potential to develop some dominance and being perceived as the go-to firm – starting at a local level and then moving beyond.

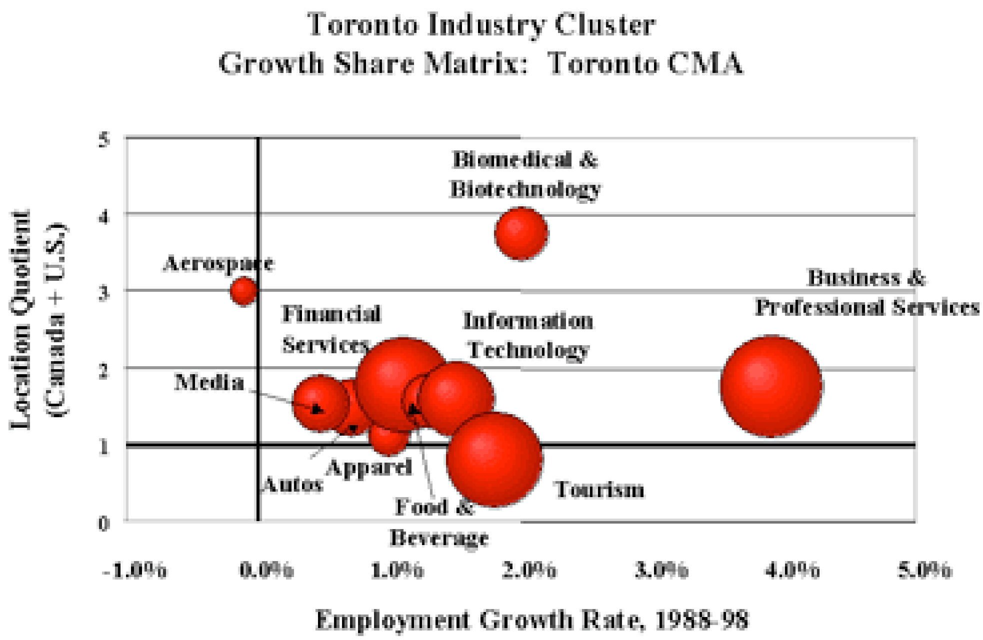
❖ At The Local Level

Here are but a few examples of cities of different sizes across the US and the one major cluster that they are best known for:

If you have an office located in:	**Whose is the perceived market leader serving this cluster:**
• Baton Rouge, LA	Specialty foods
• Boise, ID	Sawmills
• Carlsbad, CA	Golf equipment
• Cleveland, OH	Paints and coatings
• Dallas, TX	Real estate development
• Dalton, GA	Carpets
• High Point, NC	Household furniture
• Minneapolis, MN	Cardiovascular equipment & services
• Nashville, TN	Hospital management
• Omaha, NE	Telemarketing
• Phoenix, AZ	Optics
• Pittsburgh, PA	Advanced materials
• Providence, RI	Marine equipment
• Rochester, NY	Imaging equipment
• Warsaw, IN	Orthopedic devices
• Witchita, KZ	Light aircraft

Further, it is important to understand that while there may be one dominant industry cluster in a particular City or surrounding region, there are also a number of other clusters in formation.

As an example, one of our recent strategy engagements involved our looking to reposition a firm located in Toronto, intent on attracting higher value Corporate work. We examined the cluster development in that city and found no less than 10 different clusters that were developing both through a result of geographical import and governmental encouragement.



When you then examine any of these clusters, you will likely find the cluster comprised of a number of different and distinctive niches. In our case, we researched further into the Information Technology cluster to discover that it was comprised of 26,000 companies employing 512,000 employees, generating $200 billion in revenues and comprised 14 distinctive segments, including the fast growing “Photonics” niche.

Now as it happened, Photonics represented over 200 companies with a Photonics Consortium supported by Federal Government funding and 10 established Research Institutes, obviously a serious government commitment to supporting the development of this sub-industry. Also obvious, was the fact that no other law firm in Toronto had thus far targeted or been perceived to have developed a presence within this niche; and therefore no law firm had yet to develop a “first mover advantage.”

Less obvious was our client’s experience in having already done some substantive work for two of the five major players in this niche. Why was that less obvious? First, because they had never examined their market from the perspective of wearing an industry lens or through looking at clusters. And secondly, because like so many law firms, they had never bothered to capture any information on clients by four-digit SIC or industry codes (or five-digit NAICS, since 1997).

❖ At The State Level

It is not uncommon anymore for many States to organize and marshal their economic development and promotional efforts, and to throw substantial financial incentives at developing a powerhouse position in particular industry areas in an effort to stay ahead of other parts of the country. States have a vested interest in attracting the kinds of industries to their area that create the best jobs.

Here are where two major States claim to be investing their policy attention and resources:

California has an economy that is now the fifth largest in the world, with a 2002 Gross State Product of $1.3 trillion – one-eight of the total U.S. economic output. Six industry clusters have been identified as critical to the performance and future vigor of California's economy – biosciences (pharmaceutical firms, medial laboratory research and biomedical instrument manufacturing), computers and semiconductors, information technology, telecommunications (communication services and equipment manufacturing), aerospace, and agriculture.

Excluding agriculture, the five urban-based industry clusters employ more than 1.4 million Californians. And while only a small percentage of California's total employment, these industries form California's export base and contribute disproportionately to the state's economic growth.

A leading state in biosciences, California is home to several of the most dynamic bioscience regions in the country – metropolitan San Diego, San Francisco Bay Area and Greater Los Angeles. In 2001, the bioscience cluster employed some 217,000 Californians. Similarly, nearly a quarter of a million Californians were employed in the computer and semiconductor cluster. Aerospace employs close to 80,000 people in the Los Angeles region, a regional proportion that is more than two times the national average.

In **New York**, industry clusters represent groups of related industries located in one or more regions of the state. Empire State Development (ESD) has identified 13 major industry clusters, including manufacturing clusters, services clusters, and a few that are hybrids of both:

* Computer Hardware & Electronics
* Industrial Machinery & Systems
* Transportation Equipment
* Bio Medical
* Business Services
* Communication & Media Services
* Financial Services
* Materials Processing
* Optics & Imaging
* Software Industries
* Food Processing
* Distribution

ESD uses industry clusters as a framework for understanding the state and regional economies, and guiding economic development policy and initiatives. ESD and its partners have employed cluster-based analysis in the development of business marketing, export promotion, workforce policy development, regional economic planning, and other activities.

❖ At The National Level

On November 19th, the U.S. Senate approved $3.7 billion over the next four years (2004-2008) for nanotechnology research and development. This emerging science is the top inter-agency R&D priority for the Bush Administration's fiscal 2004 proposed budget, excluding medical and military projects.

"To ensure that the United States takes the lead in this new and promising field of science and technology, we must provide for the organization and guidance necessary to foster interaction between government, academia and industry," Senator Joe Lieberman, said. "The Senate passage of this legislation today brings us a step closer to providing a strong framework to elicit contributions from all three sectors and move nanotechnology research and development to the next level."

Nanotechnology refers to the ability of scientists and engineers to work with matter at the atomic level. With new tools, structural properties of matter 1/100,000 the width of hair can be manipulated. The technology could change the way products are designed and made in IT, medicine, energy, bio-technology, electronics and other fields. For IT, nanotechnology processes could possibly allow semiconductor innovation to advance Moore's Law beyond the limits of today's design, development, and fabrication tools.

The four states at the forefront of nanotechnology development are California, New York Texas, and Pennsylvania.

At the forefront in developing a Nanotechnology Practice Group was Foley & Lardner, which is not surprising given their propensity for being far more industry group focused than many of their competitors. However, what might be surprising to some, is that Foley began targeting this area way back in early 1998, when they landed NanoSystems, their first nanotechnology client and a subsidiary of Eastman Kodak.

The other law firms currently positioning themselves to take advantage of this opportunity are Burns Doane Swecker & Mathis (Alexandria, VA), Sterne Kessler Goldstein & Fox (Washington DC), and Finnegan Henderson Farabow Garrett & Dunner (Washington DC). One wonders if the Texas firms are asleep at the switch, as none of these firms have offices in that State!

These firms have all formed specialized practice groups and are seeking to establish themselves as the go-to firms for nanotechnology. Lawyers in these firms are predicting that nanotechnology will rival the semiconductor, the Internet, and biotechnology in significance.

If nanotechnology delivers on its promise — and the National Science Foundation is predicting a $1 trillion market for products incorporating nanotechnology in a little over a decade — those firms who developed a first mover position will likely be well-served by establishing their early expertise.

CONSIDER:

The point to all of this, of course, is not in creating analytical insights, it's to generate results for your firm. Understanding clusters can add a number of considerations to your firm's strategic growth agenda.

1. *Is there an industry cluster within our market area, which has previously been invisible to us, and may present opportunities?*

Some thoughtful research into the emerging developments surrounding your market may proffer new areas that you haven't previously considered.

It is important to understand what industries cluster. Not all industries tend to cluster, and clustering principles are not useful for every industry. For example, petrochemicals do not need to cluster.

This is not about exploring only areas of high technology, which as a term conjures images of Brobeck and distorts many firm's thinking about potential new opportunities. In fact, it has been said that there is no such thing as a low-tech industry. There are only low-tech companies – companies that fail to use world-class technology and practices to enhance their productivity and innovation. Even old-line industries, like Agri-business, today are inherently high tech in their applications of biotechnology.

2. *More specifically is that industry cluster composed of high growth and profitable niches representing the types of companies that we already have had some experience and a track record in dealing with?*

As you examine an industry cluster, look deeper into the segments and niche companies that comprise that cluster.

The acid test (at least for me) should be in asking yourself whether there is any other competitive firm in your market, which has developed an acknowledged reputation as the go-to firm for serving these clients. If not, then either the niche is unprofitable (do your homework) or your competitors are blind (the more likely answer) largely because they don't think in terms of industries.

(There is one further consideration, which you need to be sensitive to. For example, in the Houston energy industry cluster, members actively seek representation from law firms that have a wide industry experience – the more and the deeper, the better. There may however, be a few selective clusters where too much depth of experience may represent a business conflict.)

3. *Could we develop a practice group comprised of enthusiastic professionals willing to invest the (often considerable non-billable) time to research and learn about the*

industry, participate in the infrastructure, and effectively target the business and legal needs of these companies?

To take advantage of the opportunity professionals must participate actively within the industry and establish a significant presence. These professionals must foster ongoing relationships with the region's research bodies, educational institutions, and the government departments that are all part of the cluster's infrastructure.

Even the most thoroughly knowledgeable lawyer may likely need a booster shot of training to really work an industry, especially in the beginning. But, those willing to devote the time and attention to developing a practice that caters to a particular industry cluster may find an area that will explode by itself, carrying them along with it.

4. *Would our efforts give us a first mover advantage in being perceived as a genuine player in this market arena?*

Like many clichés, this one turns out to be true – a successful firm strategy is largely built around having strong practice groups, positioned in growing market niches, developing a distinctive presence, doing high value work.

Whether intent on pursuing additional growth or on developing a competitive strategy, both aspirations compel you to take a hard look at your firm and your practices, to challenge conventional wisdom, and to reconnect with your markets. Finding new opportunities doesn't require access to a silver bullet, just the discipline to look more carefully at the parts of your core market in which you may not have consciously participated. You could find the most attractive sources for growth in places where you haven't looked before, or where you have looked . . . but haven't seen!

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