Pressure on the Price Waterhouse Partnership: Decisions of the 1960s and Implications for Today

Kathleen McDermott[1]
The Winthrop Group, Inc.

Accountants are often in the news in the 1990s, as mergers between giant partnerships and million-dollar judgments against big firms fill the headlines of the business press. Despite widespread media attention, relatively little is known about the historical development of these large professional service organizations. A study of one such partnership, one hundred year old Price Waterhouse (PW), shows that some challenges facing the firm in the 1990s can be traced to business decisions made almost three decades ago.

Perhaps the biggest imperative of the 1960s was growth--for American business as a whole, for the accounting profession, and for PW. Despite these pressures, the partnership made a deliberate decision not to grow for growth's sake but to focus on what it had always done best and to concentrate on providing service of the highest quality. This choice was grounded as much in the unusual nature of its partnership and the strength of its self-image, as in economic or competitive considerations. In fact, PW's unquestioned professional leadership and superb client list insulated it from any real need to develop a competitive strategy and encouraged an inward-directed focus that would cost the firm dearly in terms of future personnel resources.

PW at the Top

The 1960s were prosperous times. The prestige and profitability of the accounting profession was high, and large national firms could count on a regular stream of high-quality recruits. As American corporations took their place as the world's richest and most powerful economic actors, PW and the rest of the profession rode the crest of this wave.

PW entered the decade with optimism and confidence, feelings encouraged by its history and its leading partners, and reinforced by America's political and economic dominance. During these years, the strong American

[1]This paper is based primarily on internal Price Waterhouse sources. Readers may obtain full citations in David G. Allen and Kathleen McDermott, *Accounting for Success: One Hundred Years of Price Waterhouse in America, 1890-1990* (Boston, 1993).

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economy encouraged the partnership's domestic expansion, and worldwide accounting services flourished in response to opportunities abroad. It was a decade of great promise, the culmination of the postwar period's steady growth, and an apparent affirmation of the superiority of the American way of life.

Yet there were many disquieting signs for the accounting profession amid this prosperity. By mid-decade, an overheated stock market and runaway inflation gave rise to a disturbing sense of unease. Changes in the practice environment were also important. In the first place, a wave of mergers and acquisitions eroded once rock-solid client bases. In the mid-1960s, PW audited 108 of the *Fortune 500* companies, 71 per cent more than the number audited by any other firm. PW also audited 216 of the New York Stock Exchange's listed companies, again considerably more than any other firm. However, as a result of this impressive client base of large companies, whenever a good-size merger occurred, PW was likely to be involved at least 25 per cent of the time, often on the wrong side.

> The PW stable of clients were the cream of the crop--New York Stock Exchange companies. They were basically very conservative companies, and they didn't for the most part engage in mergers and acquisitions. So we watched . . . a number of our clients being swallowed up by others, rather than our clients swallowing up others.

In 1968 alone, 26 of America's *Fortune 500* companies disappeared. Older, established PW clients in the steel industry, such as Jones & Laughlin, Youngstown, and Wheeling; motion picture studios such as RKO, Warner Brothers, and Paramount; and meatpacking companies such as Armour, Wilson, and Morrell were acquired by newer companies that had other auditors. Competition among firms for clients as well as for new hires grew markedly more aggressive. Clients switched auditors more easily, and rivalry became intense. By 1969, the future seemed distinctly less attractive than it had at the outset of the decade [1,6].

Herman Bevis, who became senior partner in 1961, brought to the position a sober dignity that comported well with PW's reputation for probity and integrity. Over the course of his senior partnership, Bevis bridged two very different worlds. His austere mien and magisterial manner epitomized the reputation of PW for integrity and quality. He saw his role as conservator of the firm's great traditions and the articulator of accounting standards. Bevis assumed control of the firm, however, in a decade when larger environmental issues required a new definition of leadership. As the firm's fortunes and place within the profession appeared to be as solid as ever, it is not surprising that Bevis's efforts were directed primarily at maintaining the status quo. But this inner-directed focus may have diverted some attention from competitive issues facing the partnership in the 1960s. As the decade wore on, reports from the field, and the relentless pace of change, made the implications of such an institutional stance ever more problematic.

"Growth became almost a slogan for U.S. industry, manufacturing and financial, in that period," recalled Bevis. "Everybody was for growth, not necessarily paying attention to why, or what the consequence might be." American companies, meanwhile, pursued headlong expansion abroad; the rapid growth of multinationals was a distinctive phenomenon of the decade, and by the late 1960s, most large American corporations had at least part of their operations overseas [2,3,4,5,7,8.]

The conglomerate was another corporate phenomenon of the era. Throughout most of the 1960s, stable economic conditions led many firms to expand operations and to diversify outside of their own industries [3-8.] These conglomerations of various unrelated businesses were sanctioned by new tax laws that rewarded prosperous companies for merging with unprofitable ones in other industries, and by antitrust laws that forbade mergers in the same line of business. Perhaps the most important factor behind this new type of merger was an unshaken belief in the decade's prosperity. The stock market boomed as many new business ventures brought their securities into the market, synergistically fueling and feeding off what would become a conglomerate craze. Twice as many mergers occurred in 1968 as in any previous year, with inflated stock prices allowing for false profits and encouraging other ingenious merger and acquisition deals [1, p. 154]. The firm steered clear of many of the excesses of the period, assuming that its time-tested strategy would withstand most changes in the business environment. The assumptions behind its important choice about growth, however, were soon challenged, and the implications of this decision were still reverberating in the late 1980s.

One inevitable result of the external business pressures that impacted the profession in the 1960s was a shifting in relative size standing among the large accounting firms in the United States. For many years, PW had been not only the most prestigious, but by far the profession's largest firm. By the 1960s, several other firms had passed PW in number of personnel, but most senior level PW partners were not particularly concerned. One later characterized this attitude as "We're doing all right; biggest ain't necessarily the best." Another recalled that nobody

> looked to the right or to the left as far as competition was concerned. We said 'we're not going to worry about them. Let them worry about us . . . we [are] Price Waterhouse.'

Growth in numbers had never been a primary aim of the firm, and as a matter of policy, partners had agreed to limit expansion until qualified personnel existed to supervise new offices.

Arthur Andersen emerged as the most dynamic, aggressive, and fastest growing of the Big Eight. During the postwar years, the Andersen firm had expanded dramatically, competing with PW to hire the best college graduates, and often offering slightly higher salaries or an earlier, faster road to partnership as part of an intentional program to invest partnership profits in new personnel.

Hard data was available to document Andersen's rise. In 1965, PW's deputy senior partner John Biegler reviewed an Andersen publication listing

their partners, offices, and revenue numbers to try to discover what factors accounted for their growth rate since World War II. Comparing the Andersen and PW data for the same 20-year period, Biegler concluded that "they were walking all over us in terms of growth." In 1968, PW distributed an in-house study listing the auditor changes made over the previous seven years by 869 significant American industrial and merchandising companies. Its conclusion must have been disquieting:

> While PW maintained a significant lead among the companies studied and in fact increased its per centage of the total, Arthur Andersen's growth performance has been quite spectacular. In a declining field, it was the only firm to increase the absolute number of clients. Of 69 companies identified as having changed accounting firms directly, (other than through merger, etc.) 17, or nearly 25 per cent selected Arthur Andersen. (About 19 per cent selected Peat and 16 per cent PW.) During that same period, that firm lost only 3 clients via that route. Of the 30 clients gained by Arthur Andersen, 22 were lost by other "Big Eight" firms; this again exceeded the performance of the other firms.

While a significant portion of younger PW partners were troubled by these developments, the firm's deliberate strategy, given its preeminent status, was to make few institutional changes. Given that the postwar period was one of apparently boundless opportunity, PW's efforts, as an elite institution acting in ways to maintain its elite status, were reasonable. Although this decision caused the loss of some market share, the firm nonetheless expanded at a heady clip and maintained profitability. Under these circumstances, tampering even slightly with PW's successful formula, or risking any shadow on its preeminent reputation did not seem appropriate. Instead, the firm explored those options most promising, and least threatening, to what it did best.

Unlike a more centralized entity, PW's leaders deferred to the concept of an independent partnership and, as a result, could really only be responsive and closely attuned to evident needs. Even senior partners could do no more than what the rest of the firm's conservative Executive Committee and partnership permitted. Many senior level partners overwhelmingly valued qualities that appeared incompatible with rapid growth, including the warmth of a smaller partnership and the maintenance of the highest quality standards.

Bevis was of this opinion. Although he warned against "complacency, sleepiness, and self-satisfaction," he also stressed that accountancy was "a profession, not a competitive industry." He publicly disapproved of the "aggressiveness on the part of some firms to bring themselves and their services to the attention of the business public."

Bevis represented an older view which, at its extreme, disdained marketing and held that the firm's professional stature was based on its reputation which was best promoted through "articles and speeches and good service" as well as "word of mouth" from existing clients and bankers. He quoted with approval George O. May, an eminent PW senior partner, who

stated that PW's best references were from those clients that had fired the firm in anger. To be sure, the general prosperity of the 1960s blunted the incentive of most firms to compete against each other. The market for accounting services was continually expanding and being redefined, providing room for many different firms to pursue their own strategies.

As PW surveyed the competition, its senior partner focused less on the techniques that other firms were using to grow in size, client base, and revenues and more on a very public, and protracted debate that had developed over accounting principles in which he and Leonard Spacek, Andersen's senior partner, were engaged. This debate occupied much of Bevis's time during a critical period when PW might have, alternatively, been developing ways to counter growth initiatives of the competition.

Over time, pressure from competitors brought calls for change from within PW. Discussion crystallized into what became perhaps the most controversial internal issue of the Bevis era, the debate over planned growth. Despite calls for change from younger partners, in the end the firm decided to make a deliberate choice not to expand the partnership beyond the perceptible demands of the 1960s, but to stay relatively small and concentrate on quality instead. Some direct results of this decision, such as partner shortages and the inability to develop particular specialties, manifested themselves within the next decade.

Change Comes to the Partnership

The PW partnership was an elite institution, and partners thought they were a special and remarkable group. Admission to the PW partnership in the late 1950s and 1960s was not easy. Partners were admitted at an older age in PW than in other firms in order to ensure greater maturity and breadth of knowledge. They could not take charge of an office unless it was perceived that they were largely self-sufficient. The firm prided itself on its rigorous and selective twelve-to-fifteen year partnership track, and the experience that this brought to the job. Six to eight years had to be spent as junior, first assistant, and then senior assistant before even reaching the rank of manager. Another five to seven years were spent as manager before becoming partner. Membership was for life in this exclusive club, for only a serious offence or drinking problem would prompt separation.

As the business climate of the 1960s began to make vastly increased demands on its partners, PW found itself facing a personnel shortage. PW prided itself on its ability to accept an unexpected audit of a huge new client like Allied Chemical, Westinghouse, or American Express, and such an assignment could result in unusual and heavy workloads. The buoyant 1960s economy boosted profits and the firm continually absorbed new staff. In addition, the national expansion of large corporate clients, and the migration of oil companies to the southwest and to the Pacific coast, required the firm to set up new offices and hire new personnel. These new offices needed partners-in-charge, for experience had shown that in many cases, only partners, not managers, could best open up new geographical areas and attract new clients.

Yet PW's traditionally selective admissions policy caused it to have fewer partners than most other national firms, some of which had more than twice as many. Peat, Marwick, Mitchell, for example, had 340 partners in 1965, compared with approximately 150 at PW. But even as recruitment goals steadily scaled upward from 500 in 1961 to 900 in 1969, the firm still faced a desperate shortage of partners. This hampered PW's ability to target new markets, to develop new services or to focus on industry specialization. Partners either were stretched too thin keeping up with existing clients, or not deployed in the right places. To resolve this issue, the firm's leadership voted unanimously in 1968 for planned growth coordinated on a firmwide basis.

As part of this process, Bevis circulated a memorandum to the partners, describing his concerns and soliciting their views. Although he resisted growth for growth's sake, he believed that "not growing would be fatal to the long-run health of the firm." He was concerned to "dispel any misapprehension about the partners now on board getting rich out of that growth." As he noted,

> per partner incomes are not appreciably increased by additional volume of work. For each increment of chargeable hours, we must have that many more partners, managers and staff. Even our overhead increases [are] in large measure proportionate to volume. Therefore the fees from the work increment go pretty well to the additional personnel and facilities which service it; the other partners get no more. In fact, if the additional work does not meet our fee scale, the partners may get less because of it.

Bevis attached detailed statistical studies to his memorandum illustrating the number of staff needed to produce a partner twelve years later, calculating how many chargeable hours of partner, manager, senior assistant, and staff were required for each assignment without sacrificing "good PW principles of careful auditing and good client attention." As he noted, "if *all* the partners *really* went all out to attract any and every new client, our chargeable hour growth rate over a period of years could be 15 per cent per annum or more." With these calculations in hand, Bevis concluded that a reasonable projection of growth would be an increase of 7 per cent per annum compounded. Considering the likely net increase of new partners and senior managers, he predicted that chargeable hours would likely outstrip resources, leaving the firm short of 24 to 51 partners by 1979, unless partners took on additional billable time to fill the gap.

Bevis's projections appeared to be a reasonable compromise between extremes of higher and lower growth rates. He postulated conservative but modest expansion while acknowledging that the firm could increase even faster. In fact, he was relying on a specific model, derived from his work with law firms:

> Why not keep PW like a Sullivan & Cromwell in the legal profession: a relatively small, distinct, super-quality operation,

> dealing essentially in mega-clients, and preserving that by constantly improving our quality?

While he appreciated that change was taking place, Bevis adhered to his own more cautious instincts, noting later that he "wasn't for making any moves just to grow."

For the critical mass of new, younger partners who had become partners since 1960, however, Bevis's idea of restricted growth was insufficient. Ambitious, questioning, and unsatisfied with the status quo, many of these had tested themselves during World War II and believed in their ability to manage. There were many debates at the partners' meetings over whether the firm should retrench and seek to maintain quality, or whether the firm should grow. A number of partners rejected Bevis's approach and chafed against restrictions set by PW's "reputation syndrome." Partners questioned at these meetings where their opportunities lay. If PW was just going to add a handful of partners every year, they argued, where would the firm be in twenty years? Would they still be doing the same things that they were doing then?

Although willing to concede that growth did not necessarily increase the bottom line per partner, some partners argued for the synergies of growing, noting that "you keep the whole operation rolling, progressing, building, enthusiastic, with good morale and lots of key responsibilities taken care of." Not surprisingly, 23 of the 116 respondents to Bevis's memorandum warned that "any plan which is expressed in terms of inhibiting the firm's growth would damage staff and partner morale, as suggesting reduced opportunities and incentives."

Even as the partners disagreed, the debate had an inward-looking aspect: the need for growth was discussed in terms of the quality of client base, the firm's personnel shortage, and the preservation of local office autonomy. Only six respondents to the memorandum noted concern with keeping abreast of external competition, an argument that assumed center stage in the next decade.

The planned growth debate clearly displayed the partnership's divided attitude toward expansion as well as the strength of the firm's traditions. Planned growth fit PW's style, with its emphasis on quality clients, a small independent partnership, and a lack of concern about its competition. In fact, the partnership only increased to 500 partners by the end of the 1970s. This figure was fairly close to the Bevis estimates.

Since PW was successful in the 1960s, Herman Bevis had little reason to question the partners' outlook. Even when external pressures intruded, such as those leading to the planned growth debate of the 1960s, they were not perceived as fundamentally at odds with the traditional PW pattern of a small partnership performing high-quality services for elite clients. In fact, the decision hampered the firm's ability to grow and specialize in new areas, and its effects are still being felt in the 1990s.

PW Today

The decision on planned growth set PW's course for the future. Its choice not to rely on sheer size, but to hitch its star to its tradition of quality, proved more transitory than predicted at the time. While PW kept its blue-chip reputation in the short term, it was unable to ignore indefinitely the larger economic and political trends shaping the profession in the 1970s.

The world began to change very rapidly after Bevis retired in 1969. By the early 1970s, an unsettled world economy and the increasing threat of foreign competition spelled the end of the postwar boom. These changes swept away the accounting profession's traditional industry structure and thoroughly transformed aspects of big firm practice. Price competition in audit work became common, leading to decreased profit margins and threatening the profession's traditional economics. Mergers reduced the client base of the major accounting firms. The economics of practice was further affected by an explosion of litigation that made the cost of doing business very expensive. These factors made the business of accounting increasingly transaction-oriented and less focused on long-term relationships. PW experienced severe personnel problems in the 1970s and 1980s, a direct legacy of its planned growth strategy of the 1960s, and exacerbated by the changes in the external environment. Despite a relatively large increase in partners and staff during the 1970s, the firm suffered from a chronic and sometimes desperate shortage of partners, causing costly delays in opening new offices and providing new services. Filling vacancies left by retirement was not so much the problem as finding the right people with the necessary skills for new offices which became critically important as the firm expanded into new specialties and geographic areas. Throughout the 1970s, the firm's leadership was directly involved in very heavy re-arrangement of partner resources and eventually, they spent more time on partner transfers than any other issue. By the 1980s, these events had taken their toll, and were further compounded by the competition for personnel with more financially attractive opportunities outside the accounting profession in investment banking and other fields.

PW's personnel problems further intensified in the 1980s with the rise of "global" accounting firms, and as size and resources became essential aspects of competitive life. Specialization, ever more important in an ever more complex world, required highly skilled personnel. Concerned about unfavorable business trends and the erosion of its traditional client base, and apprehensive about how best to service an ever-widening array of client needs, PW began to look at more dramatic initiatives. When an opportunity arose suddenly to merge with Deloitte, Haskins & Sells in the mid 1980s, PW was attracted by the prospect, viewing it as a way to achieve growth on a grand scale overnight. To the PW leadership, the potential merger seemed to be a way to fulfill unmet needs quickly.

> We would have had twice as many people, and with the then-current resource shortages in the firm, it would give us a whole bunch of able people in a hurry. And that way we could blanket

> a huge market, which we weren't able to do with our own people.

Such a merger would have been inconceivable a decade earlier, given the problems of mixing two disparate cultures.

Most importantly, the proposed merger with Deloitte would have addressed PW's resource constraints and uneven position in some emerging markets. It would still not address, however, the need to implement the specialized practices so critical to success in the new global marketplace. Had the merger gone through, one partner observed,

> We probably would have gone ahead with specialization, but not with the same zest. . . . We'd have been big enough not to have to worry about specialization as the prime tool. We could have both generalization and specialization.

The merger was voted down, however, confronting PW with the choice of continuing to support a broad-based strategy, or initiate one that was market-driven and more venturesome. The partners chose the latter and sought to develop markets critical for the success of this new policy. Before a market-driven approach focusing on service and a strong commitment to specialization could succeed, however, the firm had to marshall its professional staff and its financial resources in order to develop key markets. For similar reasons, in the late 1980s, PW also pursued and dropped more informal merger discussions with Arthur Andersen.

The end of these negotiations and discussions with other firms meant that PW missed opportunities to decrease costs and increase profitability. It emerged in the 1990s as one of the smallest of the large, worldwide accounting organizations. The firm intends to overcome this size disadvantage by anticipating and selectively targeting appropriate markets. Its strategy in the early 1990s is to identify the economic potential of such markets and to develop a strong commitment to specialization in these. To this end, the PW firms worldwide are positioning themselves to provide services in those countries where capital formation is rising and business markets are growing. Even though PW is historically strong in a number of countries in the world, it is seeking to strengthen its ties between its European firm in an effort to establish a stronger position in the European Community in general. A joint venture in Japan will assist in building a more prominent position there and in other Pacific Rim countries. To bring organizational ties ever closer, executive leadership of PW's international organization, the World Firm, is now jointly held by the senior partners of the U.S. and U.K. firms.

Conclusion

Whether the tension between PW's clear need to grow and the culture of an elite partnership can be resolved is an important questions for the firm's future. The sheer number of partners in the U.S. firm, more than 900 by the early 1990s, make it difficult to preserve traditional aspects of the PW culture,

such as collegiality and the sense of being part of an elite organization. Perhaps the partnership form itself is anachronistic, given that PW is now larger than many public corporations. Given the current scale, scope, and diverse functions of an accounting firm like PW, a long-term question remains as to whether the partnership form will continue to be best-suited to a truly global enterprise.

Notwithstanding these larger questions, history provides some explanation of how PW has arrived at its present size and scope. A deliberate decision to slow growth, in keeping with the firm's self-image, but soon out of synchronization with the profession's competitive environment, placed PW at a disadvantage rather quickly. PW's past left it relatively ill-prepared for the different demands made on large accounting firms in the 1970s and 1980s in terms of size, personnel, and capability.

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