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TO MERGE OR NOT TO MERGE – THAT IS THE QUESTION

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To quote Joan Rivers – *"can we talk?"* Everyone in law firm management is talking to everyone else – about merging. Virtually every law firm managing partner, practice area leader, executive director, and management committee/board member is asking the same question – *"should we or shouldn't we – and with whom?"* Fueled to some degree by law firm consultants, there is a growing panic mentality in the marketplace. In the minds of some, those who have recently completed a merger have passed over the bridge into the promised land, while others, either as the result of failed discussions or lack of a suitable partner, are perceived to be thrashing about in the darkness where, of course, there is the *"weeping and gnashing of teeth."*

The purpose of this monograph is to present our views on this complex topic – rationally and clearly. It is not intended to answer all of the issues in and around law firm mergers – it cannot. But, it is intended to provide a level playing field of understanding. We discuss the present state of law firm mergers, what works and what does not, and Smock•Sterling Strategic Management Consultants' approach to law firm mergers.

THE PRESENT STATE OF LAW FIRM MERGERS

Certainly every reader of this monograph knows that the topic of mergers and acquisitions is now the hottest topic in law firm management – even vaulting ahead of the associate salary increase issue (at least until the next round of associate salary increases). The primary causes for this current *"merger mania"* include:

- **Client consolidation** – virtually every industry is consolidating at a rapid rate and all at a rate faster than the legal profession – causing intense competition for the legal work remaining.
- **Globalization of law firms' client bases and legal services** – most law firms' clients businesses are becoming more global in scope, as is their legal work.
- **Outside law firm convergence by major corporations** (e.g. – DuPont's major reduction in the number of law firms they use) – because of intense competition for fewer relationships, it is perceived that the increased size resulting from a merger can put or keep a firm on the short list.
- **Perception of the need for *"one-stop shopping"*** – although we believe that this is a fallacious need (as we have yet to see solid examples where clients really want *"one-stop shopping"*), it is a voiced reason for virtually every merger.
- **Need for internal diversification** – practice groups and their market viability and potential come and go, mergers add business diversification.
- **Competition from accountants** – while we vigorously pooh-pooh direct competition for law firms from accounting firms in the United States, that situation does not exist in Europe where the Big 5 are direct competitors and will become even more so in the next few years.
- **Everyone else is doing it** – law firm leadership often tends to follow what other firms do, so if mergers are big right now, more will be doing it (there are more members of the herd than there are mavericks in law firm management).

Also, fueling mergers is the belated recognition that growth is a necessary law firm business objective. For years, many law firm managers stated that *"we do not have to grow and growth is not necessary for success."* In truth, mergers can be a relatively inexpensive way (certainly when compared to mergers and acquisitions among your commercial clients) to achieve essential growth, acquire very good people, and broaden the firm's client base.

There are, of course, different types of mergers – a larger firm can acquire a smaller firm and a firm can be acquired. Equals can merge (although there are very few, if any, equals); strategic alliances can be developed for specific practices, referrals, and related activities; or law firms can acquire and/or develop non-legal practices, more often than not some type of consulting organization.

There are some key points that can be made about the present state of law firm mergers and acquisitions.

- **Mergers are being planned and executed much better than just a short time ago**. There is better strategic thinking, often, on both sides of the merger. Due diligence is truly that, and, very importantly, there is identification of and planning for real practice group synergies. There is increased and extensive communication with partners and associates among both firms. Law firms have done a better job of setting realistic expectations – on integration needs and financial results (both costs and synergies).

- **Alliances and affiliations are being seen as reasonable alternatives to a fully integrated merger**. In many ways, more formal alliances (perhaps eventually leading up to merger) are the logical next step for law firms that are part of Terralex, LexMundi, and similar law firm groups. Already Commercial Law Affiliates (CLA) and the American Law Firm Association (ALFA) actively refer work to each other and formally market their relationships.

- **Many law firms are avoiding the inherent approval and integration problems with mergers – by *"cherry picking."*** It often can be considerably more effective and financially rewarding to only go after the attorneys and practices a firm wants, rather than taking it all.

- **There has been more discussion of cross-border mergers**. Certainly, the Clifford Chance/Rogers Wells transaction was the most visible example. Orrick Herrington talked very seriously with Bird & Bird in London before that potential merger died. There are other discussions going on now. While these can be productive (because of the globalization of the client base), we are amazed that the discussion is usually only between U.S. firms and London firms (with some discussion with continental European firms). It represents, to some degree, the Anglophobic nature of our world view. It would seem that a NAFTA based merger might be a potentially stronger union and, for many, a more logical one.

- **Law firm mergers – in most cases – are really *"acquisitions."*** We have found that, regardless of size, most law firms want to acquire and not be acquired. Thus, the least an acquired firm is willing to accept is the term *"merger of equals."* That is why virtually every press release on a law firm merger calls it a merger of equals – even if the size or market difference is dramatic.

- **Major obstacles remain even in the most strategic of law firm mergers**. There are conflicts (between clients, practices, and, often, between partners of each firm – that simply do not get along). While firm strategic planning has improved, there is usually a lack of effective strategic planning and thinking at the practice level. Often, there is just not enough analysis and planning to identify and prosecute synergies.

- **But, the biggest obstacle remains that of obtaining partners' approval to the merger**. It is our experience, as we work with a variety of professions, that law firm partners tend to be both the most individualistic and, in many ways, the most selfish. So a majority of partners in a firm may not give approval to even a well thought out, strategically sound merger, because they do not see it as being personally *"good for them."* This opposition to a merger usually does not come from the more productive partners (who more than likely will thrive in a combination), but from the less productive, who view a change in the status quo as threatening.

To sum up the present state – law firm consolidation is now accelerating and it will continue. There are too many competitive pressures on law firms today to ignore the potential benefits from a well thought-out and structured merger. While the current faddish nature may go away, the underlying serious discussion between those firms that are looking to strengthen their future positions will certainly go on.

WHAT WORKS AND DOES NOT WORK IN LAW FIRM MERGERS

Following are our thoughts on those elements that generally work well in law firm mergers and combinations and those that usually do not work as well.

What Works Well

- **Effective preparation (prior to courtship, by all parties)** – this includes solid firm and practice strategic planning (so a firm knows where it wants to go and why), partner buy-in to this strategic direction (so that the merger element of a firm's strategic direction is not a *"surprise"* to the partner group when discussions begin), and learning from others (talking to those firms that have both effectively completed and, unfortunately, did not effectively complete planned mergers).

- **Taking the time, committing the resources, and accomplishing the necessary tasks to *"do it right"*** – this requires effective planning, communication, and, ultimately, integration and the recognition that effecting a solid merger takes an unusual amount of time and psychic energy from both firms' key people.

- **Recognition, from the beginning, that the value of any merger is in practice group synergy** – the true purpose of a merger is to achieve greater market position on a practice-by-practice group basis, not on a firm basis (in truth, the only people who really worry about overall firm size and overall firm market share are other lawyers, the *American Lawyer*, and law firm consultants).

- **Continuing communications with the firms' partners throughout the merger process** – they should be kept in the loop, even if there is the risk that the merger will show up in the local newspapers or the *National Law Journal* (which it often does, well short of a decision – which is the larger risk?).

- **Considering alternatives to a full merger (e.g. – cherry picking and quasi-mergers)** – full mergers in which each and every partner comes into the new entity usually involve assimilating a considerable amount of practice and partner flotsam and jetsam (as most firms are not as effective as they should be at dealing with under-performing partners and practices). Taking only what is desired and needed is quite possibly a better tack.

- **Involving clients in the process** – ensure that key clients are aware of the potential merger and create opportunities for client input and advice (there is a fear among law firms that clients will look askance at any merger – but, it has been our experience that clients, because of their own consolidation/merger experiences, are very understanding of the need for mergers and often can provide excellent advice on how to avoid the pitfalls).

- **Setting the *"new firm"* vision and direction <u>sooner</u> rather than later** – develop the new firm's strategic direction early in the discussion process so that a high level objective is set early enough to guide continuing discussions.

- **Not merging** – a firm that bucks the trend and carries out a strategy of **not** merging (the essence of true strategy is to do different things differently) is, in many ways, a very good approach for improving a firm's competitive position.

- **Early involvement of both firms' management and administrative staffs** – involve them both because they can help facilitate the process and, just as importantly, because they can also torpedo it (remember, all the lawyers will usually be there after a merger, but there will only be one executive director, chief financial officer, and marketing director).

What Does Not Work

- **A merger for merger's sake** – that is, doing it because others are doing it and reacting to the fear that if a firm does not merge, it will be left behind (in truth, we have seen very few situations where a firm absolutely has to merge to defend its markets and clients).

- **Size for size's sake** – somewhat of a collorary of the above, but it is important to note that size, in it of itself, does not create market position – market position is a function of client awareness of a law firm's capabilities, not other law firms' awareness.

- **Forced marriages** – *"we have to find a merger partner – fast"* (the resulting entity will probably not be stronger but, in fact, it probably will be weaker).

- **Merging dramatically different cultures** – cultures should line up as much as possible, as merging vastly different cultures usually does not work (but we caution the overuse of the term *"culture,"* which is often a code word for not wanting to work very hard – not an attribute anyone would want in a merger).

- **Merging different partner compensation systems** – this may be even more difficult to do than merging different cultures, as partners are often wedded to a system that determines what and how they will be paid – frankly, they behave in response to that system.

- **Doing a merger haphazardly** – without sufficient preparation, planning, and communication (in other words, not doing it right).

- **Going forward when the synergies are not there** – in spite of common culture, agreement on major issues, and the like, if the synergies are not there, the merger will not work.

- **Mergers of two sizeable firms in the same city/geographic market** – this often does little but create a large number of conflicts and very few synergies.

- **Co-chief executive officers** – it is the current trend in almost any announced merger (except in an obvious acquisition) for a representative from each firm to be a co-CEO – our experience with law firms (and knowledge of almost the universal failure rate of co-CEOs in commercial mergers) tells us that while it may be a necessary political thing to do, co-CEOs have little chance for longer term success.

SMOCK•STERLING STRATEGIC MANAGEMENT CONSULTANTS' APPROACH TO MERGERS

Smock•Sterling Strategic Management Consultants' services to law firms are focused on helping our clients *"develop and implement strategy"* – at the firm and practice level. Because a merger or a combination is often a major implementing step of a firm's strategic direction, we have become involved in merger consultation in a number of ways – in helping select and court a merger candidate, doing strategic and management due diligence, assisting in the *"new firm's"* planning, and helping facilitate a successful integration. While we actively pursue our clients' interests, we do not broker mergers for a fee. In fact, our charges in merger assignments are the same as they would be in any other consulting assignment.

Our work in law firm mergers has expanded dramatically in the last twelve months – a reflection of the overall trend. We usually work for a specific client in the process, but have also represented the *"deal."*

If you have any questions on or want to take issue with the thoughts contained in this monograph, please contact me at the address below or e-mail me at jsmock@smocksterling.com.

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