



MERGER MANIA

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Law firm merger mania has returned in full force in the United States, Europe and Canada, according to Newtown Square, PA-based consultant Ward Bower of Altman Weil, and Lake Forest, IL-based consultant John Smock of Smock Management Consultants. Law firms seek to merge for many reasons. Unfortunately, many times the reasons are ill-conceived.

Growth, just for the sake of growth, is rarely a good reason to merge. The economy of scale sought consistently fails to materialize. That is because per-lawyer overhead almost never decreases as a result of a merger, and in fact it often increases over the long term. Large firms and multiple office firms have higher per-lawyer overhead, on average, than small firms. So increasing in size will not provide any automatic savings or improvement to the bottom line.

Sometimes mergers are driven by partner ego. It is hard to determine what benefits might be anticipated from such a merger. Too often, personality clashes are the result.

Fortunately for those firms considering merging for the “wrong” reasons, it is estimated that only 5 – 20% of mergers discussed ever come to fruition. There are a myriad of reasons why mergers fail to occur. It is the fortunate firm indeed which discovers *prior* to the “marriage” factors like clashes of firm culture, incompatible management styles, disparities in compensation, billable hours, and/or bottom line profitability, conflicts of interest, adverse client reactions, incompatible lawyer personalities and styles and so forth.

What are the legitimate reasons for a merger? In his article “Strategic Alliance As A Prelude to Merger”, Altman Weil consultant Ward Bower states

Few mergers of law firms promise the synergy likely to increase long-term profitability of the merged entity. Synergy in the form of improved profitability only occurs when merger results in increased associate leverage, lawyer utilization, realization or billing rates. These things only happen if the aggregate volume of legal work of the two combined firms actually increases as a result of the merger, resulting in increased utilization or leverage, or if the quality of work dramatically increases, raising rates and realization.

What is missing from the considerations regarding most mergers is the strategic planning component. There must be thought not just about the current capabilities of each firm, but about the unique capabilities of the new firm. How will the merger enhance practice group effectiveness and profitability? Will it add new practice areas that existing firm clients want? Will it provide access to new geographic markets which can be exploited by current practice groups? Will it provide additional depth and experience to practice groups to assist in meeting the demands of firm clients?

The real potential in the merger, as Ward points out, comes from cross-selling new services to existing clients of the two firms. Marketing gurus tell us that 80% of all new business comes from existing clients, and only 20% comes from new clients. Unfortunately, most firms are typically poor cross-marketers. Part of the problem relates to the “eat-what-you-kill” mentality and compensation system ingrained at most firms. Yet a larger part comes from the propensity of lawyers to think of themselves as individual practitioners sharing office space, instead of a synergistic whole. So the question becomes, if your firm is already typically poor at cross-marketing, how will a merger change that? Chances are it will only exacerbate the problem.

Both Ward and Smock recommend firms consider strategic alliances with other firms, rather than mergers. They believe that the benefits can be obtained from an alliance, without the risks associated with a merger. Alliances are easier to discontinue, it is expected they will change over time, and the benefits to both firms are more easily measured. And in the event the alliance is discontinued, the firm avoids the legal and public relations nightmare of a failed merger.

Mergers are expensive propositions. Aside from the partner time involved in the “due diligence” phase, which can take anywhere from months to a year to complete, (compared to only a few months in other industries), there are significant out-of-pocket expenses incurred. Announcements, tombstone ads, new business cards, letterhead, envelopes, labels, and so forth are just the start. There will be changes to bank accounts, software, equipment and property leases, and perhaps accounting and legal fees incurred to change the firm’s name and type of entity. You will need to change your web site if you have one. The partner/shareholder agreement will need modification. All the benefit plans will need to be modified, and many will be changed. Retirement plans must be dealt with. There may be space renovations needed and so forth. All of these things require time and careful thought.

Case in point: a firm of under ten attorneys merged with part of a firm which had dissolved. They moved uncharacteristically quickly through due diligence because they perceived that the “desirable” part of the other firm would be quickly “snatched up” by one of several of their competitors. Post merger, they discovered that there was a glaring incompatibility in style from numerous significant perspectives, including billing, staffing requirements and treatment of staff, marketing, and so forth. The ink was barely dry on all the new letterhead, business cards, press announcements and so forth, when the merger “failed” and the newly acquired splinter group was sent packing. In just four months, the



firm went through courtship, marriage, and divorce. It took over two years for the firm to recover financially. I suspect that the recovery in terms of marketplace perceptions will take longer.

If you or someone at your firm is considering a merger, think carefully about WHY the merger idea is appealing. Make sure the reasons are good ones. Do your due diligence, but try to set specific goals and objectives for accomplishing each step enroute, so it doesn't drag out indefinitely and consume time which would be avoidable with decent planning. Think about practice group enhancement opportunities, and whether they'll realistically materialize from the merger. And consider whether a strategic alliance might be a more reasonable and less risky step to take to achieve your goals.

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