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MERGERS CONTINUE TO INCREASE

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While mergers can be a valid option making them work is often another matter. Research indicates that one-third to one-half of all mergers fail to meet expectations due to cultural misalignment and personnel problems. Don't try to use a merger or acquisition as a life raft, for the wrong reasons and as your sole strategy. --“Does a Merger Make Sense for Your Firm?” by John W. Olmstead <https://www.olmsteadassoc.com/>]

Law firm mergers continue to increase in number in 2023, although we have not seen a return to the number experienced pre-pandemic. In addition, there has been a slight increase in long-term success of mergers.

What benefits might a firm expect from a merger?

Increased profits: There are a variety of ways mergers can result in increased profits. Achieving economy of scale is an obvious — but not guaranteed — result of a merger. Two of the largest overhead items on a law firm's profit and loss sheet include rent and staff compensation. When a merger results in elimination of a physical office, or moving two offices into one that is more efficient and lower cost per square foot, significant improvement shows in the bottom line. Similarly, when duplicate staff positions can be eliminated, profits increase.

Economy of scale can also be achieved if the combined firm has an increased market share. Aside from a reduction in competition, which can enable the new firm to save significantly on some marketing expenses or achieve better results from existing spend, the likelihood is that ultimately the firm will be able to increase rates without significant loss to clientele. This is not an overnight gain, but an inevitable longer-term benefit.

Deeper and/or wider bench: Most mergers among large firms result in a deeper bench in vital practice areas. This provides essential succession benefits. Hopefully, it will also bring some new microniche abilities in existing industries to the new firm's clients.

Widening the bench often enables more industries to become targets of multiple practice areas. It enables more cross-marketing opportunities between each former firm's client base, achieving the synergy that enables 1 + 1 to equal 3.

With an increasing one-stop-shop mentality of large institutional clients, the greater the ability of a firm to service all needs of a client or industry, the more likely the firm will be to not only retain the client, but to expand its service offerings to the client as well.

It almost goes without saying that widening and deepening the bench, and increasing industry expertise, decreases a firm's vulnerability to competition from established firms and provides some insulation from new competitive incursions. Smart competitors will often avoid trying to enter a marketplace tightly held by competitors. They will instead seek to establish a stronghold where competition is vulnerable or lacking.

Improved retention of talent: Firms of all sizes are struggling with hiring and retention of lawyers. In smaller towns, this struggle extends to paralegals and staff as well. Many midsize and small firms have significant talent and generational gaps in their ranks. This has created challenges in servicing and retaining clients, maintaining adequate capitalization and planning for succession. Most firms are sacrificing buy-in rather than lose talent.

Mergers often solve many of these issues. They can help fill in gaps in the ranks. They can also provide successors for practice areas at risk, provide more paths to equity positions and provide up-and-comers with more marketing opportunities to senior attorney's clients for possible succession or cross-marketing for new practice offerings. So, too, with increased profitability, a firm is more able to offer and maintain a competitive compensation and benefit package, while offering some lifestyle advantages.

It's important to note that large firms are significantly increasing the pressure to return to the office physically. Thus far there's no real evidence that this is necessary. From my perspective, it's more about comfort and convenience for senior attorneys, (returning to the model they have grown up in) than about maintaining firm culture and some of the other reasons bandied about. I'm just not convinced it's necessary. I *am* convinced that the forced return will cost large firms some of the people it does not wish to lose. So for those at midsize and smaller firms

who are willing to stay the course of hybrid, including-remote work models, it will be to your advantage in retaining talent and perhaps even in gaining talent.

What are the negatives that can accompany law firm mergers?

Culture clash: Law firms are mostly pretty good at vetting objective aspects of mergers by now. However, they often fail to assess the importance of firm culture to the long-term success of a merger. When similarity and difference of culture are not properly examined and vetted, one often finds that a year or two post-merger, there are a lot of empty seats around the partner table. Defections usually include vital members from each former firm.

Mergers are, or can be, very disruptive to firms. They're lengthy to complete on a day-to-day in-the-weeds basis. More than likely, the prevailing culture of the larger firm will push its way onto the smaller merger partner. It has nothing to do with which culture is "better" or "worse," but rather just the result of the integration process. All parties from each firm must commit. (In my language, commit means to get in alignment with others.) All must adjust. All must be open to change.

If you've read any of my previous articles about "attorney DNA," you know that commitment/ alignment, adjustment, and being open to change are not strong suits for attorneys. For that reason, when I work with firms on merger possibilities, I emphasize that due diligence on culture and workstyle are far more important factors to success than compatibility on billing rates, billable hour requirements or partner compensation.

The exception is that the factors included in determining partner compensation are as important as culture and workstyle. That's because you have to reward the behaviors you want to achieve. Many firms espouse one set of values, but actually reward different things. I would suggest a firm align its values to its rewards, or vice versa, before suggesting another firm sign onto the mess that likely results from the mixed message.

Hidden liabilities: It doesn't happen often, but that's not the same as not happening. Retirement plan liabilities, including unannounced impending retirement of current partners, is a frequent hidden motivator for some firms to seek a merger partner. Others include a building but as yet unrevealed surge in professional malpractice claims, a partner's hidden unethical actions or incompetence, unresolved deep conflicts between partners of one firm, impending tax or regulatory audit, lack of leadership and increasing vulnerability to loss of one or more key clients.

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This discussion is just a subset of the many possible positive and negative outcomes of a merger or acquisition. For a deeper discussion focused on your specific law firm's needs and objectives, PBA members are encouraged to contact me.

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