HAYSE LLC ADVISORY

Law Firm Merger Mania: Breaking Down the Four Elements to a Successful M&A Transaction

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Barely a week goes by without another announcement of two law firms deciding to merge or otherwise combine. The incidence of mergers and acquisitions in today's legal industry signals an increasing acceptance of the idea that growth by joining forces with another firm or group can be preferable to growth by organic means. For many law firm leaders, an M&A strategy provides a propellant that blasts their firms to a place they want to be.

According to Altman Weil's *MergerLine*, a compilation of law firm M&A transactions, the numbers on law firm M&A activity unequivocally demonstrates the tactic's popularity.

- Between 2007 and 2015, over **six hundred mergers and acquisitions closed**;
- In the three years between 2013 and 2015, **merger and acquisition transactions spiked** over the annual totals of any of the preceding six years; and,
- Merger and acquisition activity for the **first six months of 2016 is at its most robust pace** since *MergerLine* began tracking M&A transactions.

What is behind the surge in law firm M&A activity? The short answer is a variety of things; but reasons cited often include:

- consolidation
- increased competition
- profit pressure
- succession

Some firms believe that adding size, capability and geographic reach constitutes an appropriate response to the threat of consolidation, and promises a brighter future. In some instances adding proven performers in bulk to an existing roster seems like a path to competitive advantage, especially as peer firms react to industry consolidation with their own M&A transactions. Another common motivation behind merger is the belief that it is the route to sustainable or even greater profitability. And for other firms, merger offers the hope of continuity and legacy, solving succession problems in a big and dramatic way.

But being party to a combination is far from a guarantee of improved market position. Statistics indicate that law firm M&A transactions fail at what should be a disconcerting rate that some observers put at as high as fifty percent. More than a few critics think

too many firms sidestep the difficult aspects of strategic thinking in favor of merger. Approaching M&A transactions without discipline and precision is to increase the risk that the outcome will compound as opposed to remedy, the challenges so many of the participant firms face. In an industry that allows for little margin of error, making the right decision about merger or combination is critical. There are no do overs. This is hardly the time to hope for the best, and rely on luck.

Two Paths

In terms of nomenclature, the common label of "mergers and acquisitions" can be misleading. In a true merger, two firms bring together their assets and liabilities, strengths and weaknesses and forge ahead believing that as one they are stronger. Because an acquisition is at the core of the transaction, labeling it as a "merger and acquisition" could not be more apt. But the term is often an inaccurate description of what is happening with law firms. Of the over six hundred and fifty M&A transactions since 2007 identified by Altman Weil, a great many were not true mergers at all.

Indeed most law firm combinations are transactions that religiously *avoid* mashing the two firms together into a single entity. Rather, a great many transactions are simply an acquisition -- one firm acquiring from the other specific assets (lawyers and their practices), assuming limited liabilities and leaving with the targeted firm the unwanted assets and liabilities. In this variation on the theme, the acquiring firm's goal is to buy the best assets (many times all the lawyers) cheaply and leave with the target the responsibility of continuing on or winding up its affairs.

This dichotomy in transaction structure also helps delineate the two transaction participants. In a true merger, it is more likely that the two firms are roughly comparable, with similar levels of strength and weakness. If a deal gets done, they tend to negotiate a deal at arms-length and consummate a combination with the least amount of compulsion.

In the case of acquisition, one firm is usually larger or more dominant than the other. In such cases, the larger or more dominant firm negotiates with the acquisition target from a position of strength. The disparity in size and strength factors significantly in the negotiations and provides leverage but does not always guarantee that a transaction makes. Indeed, smaller or even weaker firms frequently walk away from a proposed deal due to discomfort with the idea of being consumed by their counterpart.

Element One -- Living Alone or Getting Hitched: Why Merge?

"Popping the question" or saying "I do" presents a watershed event in the world of interpersonal relationships. If exercised with maturity and the desire to achieve lasting happiness, a lot of care and thought goes into making such an important decision. On

the other hand, a future together that looks tenuous can prevent a meeting of the minds (or hearts) and negate, at least for the present, a union.

In law firm matrimony, it should be no different. Ill-fitting partners are best avoided.

But before deciding whether a particular marriage realizes one's expectations, there comes a point where the existing state is weighed and tested. If things are great, or at least good and comfortable, the idea of casting aside present independence in favor of sharing all with someone else has to be broached. Joining with someone or something not presently in the picture should only occur if things will improve, and greater happiness is in the future. If that test does not yield a positive response, the nuptials should not be pursued.

The lesson is obvious. Law firms should never consider a merger, or be party to an acquisition unless a compelling case can be made that it improves the law firm. The reasons often offered to justify any type of combination can be as varied as law firms are. Commonly, firm leadership convinces itself that its clients or markets will be served better if capabilities currently not at the firm are added. Sometimes that very reason prompts firms to go beyond current markets or borders to enter a new market where the needed expertise can be found.

On other occasions, entry into a new market is driven by the market's attractiveness to already established practices, thus complementing and filling out a recognized substantive capability and/or presence the firm enjoys. And of course, the opportunity to expand through merger and acquisition sometimes comes from the belief that additional market share will result after bolstering the firm with attorneys and practices that bring along considerable books of business.

Not all reasons to pursue combination are positive. More than a few firms have had to consider an M&A path due to less shining circumstances. A struggling firm may be concerned about its prospects for the future and seek out marriage partners in hope of rescue. Other firms in less dire straits may nonetheless think that an M&A transaction will fill a leadership vacuum or solve the absence of a sound succession plan.

In any case, successful merger and acquisition is premised on a firm's identified strategic imperative. Some of the reasons pinpointed may seem more compelling than others. A few may be viewed by observers as wrongheaded. But at least a strategy is at the heart of the transaction itself. Notably, absent from the list is the idea that growth alone serves a purpose and provides the reason for pursuing a merger and acquisition.

Element Two -- Finding Mr. or Ms. Right: The Courting Process

When a firm thinks that the jump-start of a merger and acquisition would be strategically helpful, finding the right partner is the next step. Taking that step, however, should be more than immediately putting out the word or hiring a search firm to present candidates for consideration. Finding the firm or group of lawyers that advance your overall strategy involves the preliminary but vitally important exercise of defining the criteria for a successful match. The principles established at this juncture provide the necessary and bedrock guidance for what can turn into a whirlwind process. Taking stock of what constitutes personal happiness is done every day -- and it is no less applicable in the quest for the right merger partner or addition.

Defining the criteria is a hollow exercise if discipline to search according to the criteria is lacking. If the possibility for success were heightened because a candidate displays characteristics that satisfy an articulated set of standards, why would a search take seriously candidates whose make-up misses the mark?

Once the hypothetical candidate is profiled, a proactive and methodical approach in search of that candidate maximizes the likelihood that a combination will actually realize strategic needs. Even if the merger and acquisition process is more reactive and opportunistic, maintaining the discipline to measure presented firms or lawyers against understood principles cannot be relaxed. If your standards get murky or confusing, it is time to stop the courting process.

Discipline means a couple of other things. The meet and greet process can be long and trying. It may result in fatigue over the process itself. Indeed, at such a stage a superficially pleasant candidate may seem right or acceptable for the next step. At this juncture it is critical to ask whether, based on the principles endorsed at the outset of the exercise, the "acceptable" candidate fits the bill. If not, the firm should be prepared to move on.

A corollary is to remain mindful of the yardsticks that help measure a candidate's acceptability when the thrill of the conquest hits a fever pitch. As exhilarating as the hunt may be, a firm seeking a partner or large addition must be vigilant about only moving forward with the opportunity that satisfies strategic objectives.

Element Three -- Making the Smart Choice: Is there Compatibility?

At some point the dating around progresses to something a little more serious. There may be a lot to like about a particular firm or group of attorneys; and the idea of joining together may seem right. Whether a long engagement or a short one, a smart firm conditions the final step to the altar on being certain about the suitability of the match.

Reaching that point requires a relentless commitment to test compatibility based on the highest standards.

Getting started correctly is the most important part. Whether the large firm or small one, the dominant or weaker one, the guiding principle involves developing a detailed and thorough plan. Begin with obtaining information that helps evaluate the compatibility metrics of culture, finances, clients, compensation and operations. Digging deep into those five categories helps identify whether a fit is possible.

Even if the analysis generally is positive on the five compatibility metrics, careful firms go further. The quality of leadership must be evaluated. How has the firm or attorneys dealt with adversity? How satisfied do your counterparts view their own leaders? Are they fair, organized and disciplined? The way in which these questions are answered can be impactful. Leadership and client relationships may facially look good, but if senior lawyers reaching the age of retirement are in charge of these vital functions, knowing the details about any succession plans is important. Who will be the next generation of leaders?

All the data uncovered in diligence may create the conclusion that the opposite firm or group is suitable based on the compatibility metrics. But law firm longevity also depends on leadership's vision. When firms or lawyers come together, the vision behind their respective success must be compared and to some degree at least, compatible. A conservative vision might conflict with an aggressive one, a regional perspective can run counter to an international outlook and so on. Making sure there is a cohesive visualization of the future cannot be ignored.

Admittedly, firms generally do not have the option of living together first. But the principles that can cause individuals in the personal context to sometimes exercise such a try-out can nonetheless apply to firms in the period between the decision to combine and the actual closing. During the period prior to closing inevitably issues will arise that must be resolved if the combination is to succeed. How the two firms work together to smooth over hiccups after a letter of intent gives a look into each firm's personalities and culture. Resolving business and ethical conflicts as well as addressing human resource issues during the interim period can provide a measure of what life will be like if the deal is consummated. This period of "living together" can be the last opportunity to evaluate the future and call off the engagement if warning signs appear.

Element Four -- Building an Enduring Relationship: A Marriage Takes Work

As noted at the outset, more than a few respected commentators on law firms and the industry assert that about half of all mergers fail. Other data focused on lateral hiring success suggest that adding groups of lawyers as a strategy is a mixed bag. Collectively, these two approaches to merger and acquisition present the classic risk/reward

quandary. With such an uneven record of success, it is very important that any merger and acquisition participant do all it can to maximize the chance for positive post-closing performance.

Beating the odds of failure should not be left to chance. Indeed, much can be done and should be done to position an acquisitive firm for a successful ending instead of a gloomy one. Among the most important measures a firm can take is to develop a deep and well thought out integration and assimilation plan. Giving voice to an integration and assimilation plan *prior* to closing is one of the best ways to assure success and protect the firm. By doing so, difficulties inherent in blending two groups of lawyers and personnel can surface prior to closing. In some cases, the warning signs about a looming dysfunctional integration may be so profound as to augur in favor of killing the deal. As disappointing as it can be, problems with the ability to integrate two groups is best learned in the engagement phase and not delayed until after the marriage. Like they say, "think of the children."

Moreover, any plan should be the product of contributions from the acquiring firm and the target firm or group and specifically address the objectives, methods and deadlines for integrating two firms, two practices and two cultures. The path to integrating into a cohesive whole should not be dictated from the top but should engage as wide a range of perspectives as possible. In the effort to integrate and assimilate new lawyers and personnel into the firm, practice must meet theory with specific milestones established for the firms' potentially disparate parts to blend.

A good plan that involves the entire firm helps form a single culture out of many. Such a plan often includes a blending of multiple systems, processes, and procedures or the creation of new ones that guide, measure and inform the firm, its attorneys and personnel in the conduct expected, the resources to assure success, the way to success and areas that lag behind as the integration takes hold. The objective is to create a single set of expectations, rewards and means for assessing performance. As the unified firm moves forward, it can treat its attorneys consistently and manage struggling areas on an apples-to-apples basis.

Finally, a sound integration and assimilation plan thinks about, plans for and pursues the firm's future through the care, feeding, schooling, and recruitment of the firm's next generation.

Conclusion –- Sound Strategy and Discipline Are Keys To Success

Among the numerous transitional events a law firm can face, merger and acquisition can be the most transformative, debilitating, or somewhere in-between. How well suited a particular M&A transaction turns out for a firm depends on many things

including pre-transaction strategic thinking, proper marketplace examination, due diligence, and integration/assimilation forward thinking.

Getting it right requires discipline, judgment and a never-ending dedication to doing what is in the best interest of the institution. Although many firms think that they have the gear to make the right choices, affirmation of that belief only comes, if it comes at all, long after the egg has been scrambled. The rewards can be high, but so too are the risks.

While it may be said that the report card for a successful M&A transaction may come late, the tardy report largely acts as a reminder that a deal turned out well. The same lateness for an M&A deal that turns out poorly is far from being celebratory and can have negative consequences that are, sadly, difficult to counteract. So in this time of merger mania, approaching the significant transitional event of merger and acquisition requires a well-considered strategy executed with precision. Anything less is too troubling to contemplate.

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