United we stand

Many law firms may be considering merger as an option in response to increased competition in the marketplace, but the process is never simple. **Nick Jarrett-Kerr** explains how to assuage partners' fears and make a merger work for you

Lawyers are good at concepts. This means that the increasing likelihood of legal market consolidation comes as no shock to most; they can analyse other professions and sectors in which consolidation has already taken place, and then readily accept that the legal sector is fragmented and ripe for rationalisation. When contemplating a merger, they understand, too, that such a move is not a strategy in itself, but a possible means to attain strategic goals. They are quick to see the advantages of scaling up, gaining critical mass, and building specialist teams. They know, almost without being told, that, in the new legal order, the power of branding will only increase further, and that small firms will continue to be edged out of their traditional markets and client-winning streams by the referral power of institutions, corporations and chains.

However, when it comes to merger planning in their own firms, theory is easier than practice. So how can a law firm plan effectively for a merger which will work in its own specific context, help it to achieve its aims, and ease integration efforts?

It is often helpful to understand that there are four main types of merger for law firms, as follows.

ABSORPTION

The acquiring firm takes over the target firm (usually much smaller, or maybe in crisis) and replaces all operational, strategic and cultural systems with those of the acquiring firm. The project is, in effect, treated as a bulk lateral hire. As a very rough rule of thumb, in an absorption merger, the acquiring firm can digest firms of up to one-third its size. Larger acquired firms may not be able to control voting within the merged firm, but will undoubtedly influence change within it.

ALLIANCE

An alliance merger most often involves bringing together offices in different regions or jurisdictions. The combined firm will operate much as before in its different offices. Operational and cultural differences are allowed to exist. The main goal is to achieve an effective working relationship, rather than complete integration.

ALCHEMY

The alchemy merger is based on the expectation of synergy. To form the means to a strategic end, such a merger requires full consolidation between the two firms, with integration efforts being oriented towards a blending and assimilation of people and culture. A successful alchemy merger requires an alignment of the business models employed by both firms. This is easily the most difficult merger to effect and to integrate.

ASSET-STRIPPING

This form of merger (until now, relatively unusual in a law firm context) takes place where a firm is acquired and broken up into different parts, with bits hived off or integrated in order to make a fast profit.

(These four As have been derived from a number of models including Maister's five types (Menu Approach, Bulking Up, Dots Approach, Alchemy, and Crisis) and the University of Southern California Center for Effective Organizations' four types (Pillage and Plunder, One Night Stand, Courtship / Just Friends, Love and Marriage) as well as Stephen Mayson's 3C spectrum of the glue holding firms together (Convenience, Complementary and Combination).)

Objectively, it is often relatively straightforward to prefer one of these four types for the pursuance of strategic objectives. The problems often, however, come at a subjective level. In his legal work, a lawyer's logical analysis and objectivity always override his natural sympathy, emotion and subjectivity. While he may empathise with his client, his role nevertheless requires his head to rule his heart. But when lawyers consider their own businesses, the reverse is often true – the heart tends to rules the head. I have known several instances where 'no-brainer' mergers have failed on emotional grounds where, in other sectors of professional services, personal issues would not have been allowed to cloud a higher strategic imperative. Of the four types of merger, the alchemy type is the most intrusive and potentially unsettling. The prospect of such a merger will inevitably give rise to a number of strategic concerns and partner objections.

The rest of this article looks at 10 typical and heart-felt objections to merger, and how to deal with them.

1. WE SHOULD WAIT FOR THE PERFECT PARTNER

For a merger to help achieve some worthwhile strategic goals, the candidates for merger should be carefully considered, filtered and chosen. An indiscriminate choice of merger partner – or discussions started just because two senior partners know each other – almost never succeeds (though a discriminating merger between two long-standing 'friends' often works well). It is best to draw up a set of criteria or scorecard of desirable attributes, characteristics, skills and strategic positioning, and then create a shortlist of firms to be approached. Even with good friends, it is important to test their attributes and core strengths against some strategically-focused criteria.

If the firm is seeking an alchemy merger, it is particularly important to ensure that the firms are truly complementary and synergistic. Early business planning of the suggested merged

entity (during the course of the negotiations) will help to identify true synergies and takes account of merger costs and benefits.

However, while an indiscriminate or knee-jerk choice must clearly be avoided, the partners should also be aware that absolute perfection in a merger partner can never be attained.

2. WE MUST RETAIN CONTROL

The appeal of the absorption merger is obvious to many partners, as it leaves the acquiring firm in continued management control and preserves, for the partners, a continuation of everything to which they have become used in the way of offices, systems, accountabilities and so on. A palatable alternative for both firms may be an alliance merger, under which each may carry on much as before; however, both need to be convinced of the benefits of such a potentially weak combination. In both types of merger, partnership hierarchies and positions may continue as before. However, the desire for control – if widely shared – probably limits the firm's options and could set up an impenetrable barrier to alchemy mergers.

3. WE MUST PRESERVE OUR CULTURE

Some elements of a firm's culture will differ from that of other firms simply because of historical differences as a result of their evolution; others, however, are essential to the success of each of the merging firms. It is worth remembering that it is far easier to influence and change behaviours than to change the culture of an organisation. Like the first objection, this objection mostly affects the alchemy merger; in such a merger, it is problematic to expect the target firm simply to adopt the other firm's culture.

To assuage the concerns of those who raise this objection, the firms involved must try to establish the cultural traits exhibited by each firm, and see if they are compatible. However, law firm culture is very hard to pin down. One option is to ask objectors to define what they perceive the culture to be, and which bits of it – behaviours, values, traits and so on – they want to see strengthened or developed. The chances are, though, that they will emphasise superficial 'fluff', such as 'collegiality' and 'a nice place to work'. Another option might be creating an online cultural inventory for all staff and partners to contribute to.

4. WE NEED TO GET STRONGER BEFORE WE MERGE

I have some sympathy with this objection. Mergers clearly work better from a position of strength than from one of weakness. Occasionally, a firm might consider being acquired by a stronger firm in order to gain some strategic or positioning objectives, but in such cases, it is better to press for an alchemy merger than risk the prospect of being lost in the crowd via an absorption acquisition. However, this objection often conveys a hidden fundamental distaste for merger as a way forward, and is one of a number of ways in which partners can procrastinate essential decision-making.

5. I WILL LOSE MY INDEPENDENCE

At a superficial level, planning the formation of practice groups, departments and teams for the combined firm should not prove difficult. Role definitions are, in essence, a matter of drafting, but who takes what role is trickier, and may leave some individuals feeling that they will end up with less influence, and under more control by others. It is vital to manage expectations at as early a stage as possible. Early work on budgets and departmental

business plans (both in fee-earning departments and in areas of professional support) will not only help to identify advantages and disadvantages of merger, but also highlight role conflicts, the superfluity of some personnel, and underperformance issues.

6. MERGER MEANS CHANGE AND I DON'T LIKE CHANGE

Most mergers fall at the first few hurdles of discussion and negotiation. It is important to be clear from the start about the level of change required, and to assess rigorously whether making those changes will be feasible in the context of the combined firm. Partners tend to resist change the most when personal change, organisational change and macro change – political, economic, social and technological – are all taking place at the same time, and overlap. In the merger context, partners will inevitably be concerned about the possible impact of the changes on them, and even if conceptually supportive in organisational terms, may quickly become obstructive or silent objectors if they feel

Continued on page 26

Continued from page 25

personally threatened. Possible solutions include watching for signs of stress and changes in mood, and providing careful 'coaching' of and support for those who appear to be finding the changes really difficult. The key during any merger discussion is 'communicate, communicate, and communicate'.

7. IT WOULD COST A LOT AND AFFECT PROFITABILITY

Concerns are often expressed over the loss of prior investment in the firm's name, people, systems, leases and infrastructure. Operationally, premises are usually one stumbling block. If, for example, the combined firm is not able to get under one roof fairly quickly after merger (or use the same systems and infrastructure), then the merger is likely to end up as an alliance merger rather than an alchemy one. There is also usually a considerable cost associated with mergers.

It is therefore vital to work out, at an early stage, both the likely merger costs and any possibly show-stopping issues. Hopefully, such analysis will also highlight any potential cost savings.

8. I MAY LOSE OUT PERSONALLY

In looking for any merger candidate of significance, the firm will probably be honing in on firms with strong partners (possibly with big egos!) who are successful in winning and sustaining high-level clients. A firm of 'shrinking violets' is unappealing, even if such a firm would prove to be more compliant and easy to digest. There will, therefore, inevitably be some duplication of roles, although a truly strategically focused merger will try to avoid the risk of 'bulking up' the firm with more of the same.

It is important, therefore, to identify those individuals whose practice or role may be most affected, and to have personal discussions with them on the way forward. The clear aim should be to persuade them to participate in the negotiations and to support the strategy, rather than undermine the process. Where partners are worried about a reduction in compensation, it may be possible to consider transitional arrangements to give them some certainty and comfort in the short term – provided, of course, that overall profitability is maintained.

9. I DON'T KNOW IF I WILL LIKE OR TRUST THEM

It is clear that a substantial level of change will be required following the acquisition of even a small firm. Law firms are people businesses, and because of this, there is huge potential for dysfunction in law firm mergers. There are a numbers of reasons for this. First, there is no history of continuing relationships upon which personal trust is usually built. Second, many partners consider that their knowledge and their client relationships belong to them personally, and not to the firm. Third, partners usually enjoy considerable operational autonomy, and do not respond well to new disciplines, the enforcement of defined roles, or accountability for quality and performance.

The extent to which these issues become challenging or important will depend on the type of merger and the level of integration which the merger arrangements will require. It has been proved that personal, interpersonal and partnership dynamics following the merger of two firms are significant determinants of merger success or failure. Considerable effort therefore needs to be expended in ensuring that the target firm does not contain antisocial, overly controlling or difficult partners.

An alchemy merger is easily the most difficult merger to effect and to integrate

10. IT MIGHT ALL GO HORRIBLY WRONG

Some partners tend to be more consumed by the fear of getting a merger wrong than motivated by the buzz of getting it right. Some firms have therefore incorporated demerger clauses in their merger documentation, to cover the possibility of disaster. The problem with this approach is that, when the time for the break clause approaches, the merged firm could potentially argue itself into a self-fulfilling prophecy.

There is no easy way round this issue, except careful pre-merger planning and persistent implementation of merger integration initiatives. The more the firm integrates, the more difficult it is for the firm to reform into its previous legacy constituents. Hence, the alchemy merger – if truly integrated – tends to be more difficult to unwind than the other types. At the end of the day, individual partners always have a career choice to make, and their choice to continue in a firm where they have become unhappy may not be appealing in the long term.

GETTING THE PLANNING RIGHT

All these objections highlight the need for careful and insightful planning and communication, to avoid both undue caution and the rash excitement of closing a deal.

There are four key principles to remember in discussions and negotiations. First, both firms should maintain focus on the strategic and business case and potential benefits; a compelling and carefully crafted business plan can help overcome early objections and possible deal-breakers.

Second, both sides should maintain a position of generosity and goodwill. Neither should avoid raising tough issues, but both must remember that they will have to work together in the merged entity; it is not wise to hammer home unduly hard bargains.

Third, someone must consider and represent the interests of the merged firm in the discussions, in order to keep both sides from falling into polarised positions or indulging in point scoring, and to maintain focus on the future.

The final and most difficult principle is to plan early for integration. The challenge is that the very strengths which a firm may seek to protect are likely to make assimilation and integration more difficult. It would be all too easy to walk away from a possible synergetic merger because of perceived integration difficulties.

The alignment (or otherwise) of each firm's strategic intent (identity, purpose and vision) is a critical element in the pre-merger analysis. If the two leadership teams see eye to eye about these issues, share similar values, and are equally driven towards the same strategic objectives, then it may be possible to forge a guiding coalition which will help both to implement the merger and to kick-start the necessary steps towards integration. ■

Nick Jarrett-Kerr (nick@edge-international.com) is a member of global consultancy Edge International, a founding member of the Law Management Section, and a lecturer and author on law firm management.