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Getting More from Mergers

Unquestionably there are successful law firm mergers, some hugely so - perhaps most notably the strategically sound international ones that have created the grouping of highly profitable leading global firms that are increasingly winning a larger share of the highest value work. At the opposite end of the spectrum are the many smaller mergers, often significantly defensive, which while not transformational to the industry have provided the scale to allow the firms involved to maintain their market position and continue to compete effectively in a consolidating market; we cannot know for sure what would have occurred without merger but for many as smaller independent entities they would likely have been squeezed into unfavorable positions.

In spite of these success stories, there are still mergers that provide less value. Research over the past few years by both leading business schools and the Big 4 Accountants has concluded that the significant majority of corporate mergers and acquisitions do not deliver the anticipated revenue or cost benefits and indeed often dilute rather than create value. While these studies do not cover law firm mergers, we know that a number of law firm mergers have similarly failed to achieve the anticipated strategic benefits, such as better market positioning, winning larger or more complex projects, and delivering substantially higher profits.

A key reason we believe that many law firm mergers are delivering less value than they should is because insufficient focus is given to a key determinant of success – revenue growth.

The foundation of a successful merger is a strong business case that is relevant to, and centered on, clients. Success in merger is highly dependent on client expansion and income growth. Unfortunately, some merger discussions fail to produce meaningful analyses or forecasts of potential revenue growth that will result from the combination. In fact, some firms even default to focusing on potential cost savings rather than potential revenue growth opportunities. To a certain extent this is understandable. Potential cost savings are more tangible and forecasts can be built by reviewing the income statements and budgets of the two firms. But given that law firms are high margin businesses, cost savings will deliver far less impact than revenue growth over the long term.

Identifying revenue growth opportunities is more difficult and generally much less certain. It isn't, however, impossible. And particularly importantly, a focus on this can help identify the key actions the merged firm needs to take once it is launched. Income growth can come from existing clients - providing a greater volume of services to them (and possibly at better margins) - and/or by attracting new clients. Opportunities to provide a greater volume and range of services to existing clients can be evaluated in a variety of ways, including assessing key clients of the two firms, evaluating the relative strengths of the combined firm compared to other firms working for each key client, considering lost opportunities with existing clients, assessing recent declines in work, etc. Focused mergers which create revenue growth utilize these types of assessments to build forecasts of the revenue growth and client expansion opportunities likely to result from merger.

Less commonly undertaken but generally the best source of valuable information are interviews with clients of each firm. They can be powerful in not only exploring clients' opinions of the proposed merger but also help identify the potential (and steps necessary to realize this) to attract a greater volume of work in the future. This is absolute gold-dust in terms of input to planning and executing the merged firm's integration and business plan. Clearly the timing of such research needs to be carefully considered - in particular if there are confidentiality issues. Our experience, however, is that clients are happy to be involved in such discussions, are pleased that their views are being sought and will respect confidentiality.

The potential for attracting new clients tends to be a largely internally focused exercise. It is often undertaken at a practice or industry group level and can be based around exploring the two firms' existing 'target client' lists. It provides further opportunities for partners in the same practice groups of each of the firms to work together to identify how in combination they might be able to attract specific clients and work and how the greater strength and capability of a combined firm might succeed.

Wider opportunities, created for example by one firm having a particular service capability that the other firm doesn't can also be explored. The assessment can also focus on lost opportunities – lost pitches for example, or circumstances when perhaps neither firm was even invited to pitch. An honest assessment of whether the outcome might have been different had the two firms been combined can be a useful data point.

These discussions, providing they are well planned and managed, also have wider benefits beyond the immediate task at hand in terms of allowing partners to get to know their future partners and understanding each other's respective skills, expertise and way of working. This exposure helps in the combined firm integration efforts and helps to bring revenue opportunities to the firm more quickly.

Of course, activities such as these will not come up with precise forecasts of revenue growth. That, however, really isn't the point. If they fail to identify meaningful revenue growth opportunities, we would argue that they highlight the need for there to be some extremely powerful alternative rationale for the proposed merger. And if they identify more promising income growth opportunities they can be a critical input to the setting of objectives and planning for the future success of the merged firm. Without such analyses firms can believe that there are income growth opportunities without evidence to support it and can miss opportunities that do exist by being unaware of them and hence not focusing efforts accordingly.

We are certainly not advocating for any lesser focus on identifying the potential for cost savings in a merger. What we are arguing is that far greater focus should be placed on identifying the revenue growth opportunities because it is here that the potential for success of most law firm mergers lies.

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