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Responding to Growth Pressures: Best Practices for Evaluating Merger

Law firms are facing intensifying growth pressure. Competitive and client forces have pushed law firms to not only focus on increasing revenue and profitability, but perhaps more importantly, to add practice depth, practice breadth, overall scale, and geographic reach. Significant investments in lateral hiring and law firm combinations have changed the competitive landscape by forming new, dominant firms in particular practice areas, industries, and geographic regions. This has reshaped the AmLaw 200, with an increasing number of firms now offering considerable scale and reach compared to existing competitors, regionally, nationally, and internationally. This evolution has created new choices for clients seeking advisors who can provide services across multiple jurisdictions or offer superior depth in particular practices and industries, further fueling the race for market share and the pressure on law firms to grow.

In light of these growth pressures, an increasing number of law firms recognize that achieving their strategic goals and remaining competitive will require greater scale and reach than they can realistically build organically. Unfortunately, too many firms invest substantial time and resources pursuing merger opportunities which never come to fruition. A material number of potentially strategic mergers are not completed due to inadequate management of the merger process – failing to sufficiently test key aspects of strategic, financial, and cultural fit early on in the process or failing to bring their partners along in the process. Taking the right actions early on can help firms avoid over-investing in merger opportunities that cannot or should not materialize, and to focus on those opportunities that offer the greatest benefit to their clients and their people.

So, what are the most critical areas firms should focus on in managing the merger process? And what is the general staging for addressing each of these elements of the process?

Define the Business Case

First and foremost, firms must invest in defining and articulating the strategic rationale for a combination early in the process. The most successful merger processes typically involve leadership discussion of the business case at the initial meetings, and then continuing to cultivate business case discussions throughout the remainder of the merger process. The business case must be explored and documented, starting at a 30,000-foot level and then progressing to a greater and greater level of practice, industry team, client, and operational level of granularity as the merger discussions advance over time. Too often, firms fail to adequately articulate the strategic rationale for the merger. In these cases, merger discussions are much more likely to break down when difficult issues arise. Without a strong business case, firms and their partners tend to lose sight of the upside of the combination. And without a well-defined and communicated business case, firms lack the ability to defend the merger against the inevitable opposition from skeptical partners.

Plan the Process

Once the two firms have developed initial thoughts on the business case, a key next step is to agree upon a process and general timetable for future discussions. Merger processes often consume an inordinate amount of resources - from conflicts checking, to due diligence, to defining the business case, to exploring deal terms, and so on. The goal of process planning is to ensure that both firms understand and are committed to the magnitude of time and resources needed to explore the opportunity and are realistic about their ability to move the opportunity forward within their respective partnerships. While merger discussions rarely proceed according to plan, seeking to align on a process and timeframe enables firms to test their merger partner's appetite and ability to pursue the merger in a serious and focused way. And of course, a general timetable and plan results in a better managed process and helps avoid situations where one firm is operating with a far greater sense of urgency, while the other is working at a much more gradual pace.

Identify Deal Breakers

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Successfully moving a law firm merger forward requires tackling a short list of critical, 'deal breaker' topics. These topics include firm governance, partner compensation, partnership structure, capital, voting rights, and firm name. Too often, firms dance around these topics for many months of merger discussions – describing their current processes to one another and avoiding hard conversations about how the combined firm would handle each issue. In some cases, firms even believe that their discussions are resulting in alignment on these topics, but in fact, they are not really on the same page. While merger processes that drill down too quickly on too many of these critical deal breakers at once can alienate participants, merger discussions that avoid tackling these topics result in failed combinations. Firms must seek to strike the right balance of a methodical and staged process to address each firm's respective deal breakers early on in discussions, while concurrently exploring the business case to ensure that both sides remain motivated to work through the hard conversations. The stronger the business case, the more likely it is that solutions to deal breakers will be found. That said, even a stellar business case simply cannot overcome true misalignment and disagreement on critical deal breaker topics.

Conduct Due Diligence

Law firms are often keen to kick the tires of their prospective merger partner – sometimes to a point where the firm becomes so overly focused on finding the skeletons in the other firm's closet that they lose sight of the strategic advantages of the combination. However, we also observe merger discussions where firms fail to identify financial fit problems or material conflicts early in the process. Or in other cases, firms identify the potential issue, but do not dedicate sufficient time to understanding and testing the severity of the challenge early enough in the process. Naturally, discovering a 'skeleton' late in the process is never a good thing, so the need for careful due diligence and conflicts review simply cannot be underestimated.

Cultivate Partnership Support

Perhaps one of the greatest challenges in the merger process is bringing the partnership along in merger discussions and evaluation of an opportunity at the right time and in the right way. The larger the combination, the more challenging broader partnership communications about a merger become due to confidentiality concerns, risk of premature media coverage, and the likelihood that a portion of the partnership will begin to mount a resistance campaign. Our experience indicates that in most circumstances it is more effective to keep a partnership informed of progress as discussions proceed and seek partners' input, endorsements, and commitment on a step-by-step basis rather than attempting to 'sell' what may be regarded by partners as a done deal. Keeping partners informed involves more than simply communicating status updates and sharing information, but also requires that firm leaders truly engage their partners in exploring the merger opportunity in order to garner their support and buy-in. Cultivating partnership support for a merger requires time and energy from a broad group of leaders, but it results in the case for merger being tested throughout the process, allows leadership to maintain a close sense of the mood of the partnership and, most significantly, builds commitment and reduces the risk of failure at the final stage.

In our experience, successful merger processes approach these five critical aspects of merger as concurrent work streams, by simultaneously exploring the business case, tackling deal breaker topics, conducting due diligence, reviewing conflicts, and gradually involving an expanding group of partners in the consideration process.

A poorly managed merger process carries a high opportunity cost – it risks failing to execute on a strategic opportunity, wastes valuable leadership time, hinders the firm's ability to pursue other firm strategic priorities, frustrates partners (and even risks partner losses), compromises the chances of a future merger, and is a dangerous distraction from serving clients. Effectively planning and managing merger discussions is a tremendous lift of management time, resources, and energy, but it is a necessary investment. A well-executed merger process enables firms to focus on opportunities that will contribute to successfully advancing the firm's growth strategy and provide the greatest benefit to the firm's clients and people.

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