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A case study of a successful merger process - part 1

Managing successfully the processes involved in initiating and concluding a merger between two law firms can often mean the difference between achieving a deal or not. How many potentially good mergers between firms have fallen by the wayside because of a lack of knowledge or experience in handling the processes involved in bringing two firms together?

In this month's Briefing Note I set out a case study of the initial stages of a merger discussion up to the conclusion of the initial meeting between the two firms when it was agreed to meet for a second time. The eventual merger was the end result of processes which the two parties went through to bring their discussions to a successful conclusion, which processes were well planned and handled effectively, and so are likely to be helpful to other firms which may now be contemplating mergers. One of the managing partners involved kindly agreed to answer a series of questions put to him and his answers are set out below.

What were the factors that led to the decision to seek a merger?

Following a detailed review of our market place, including where the market was going and in particular our competition, we recognised that we had certain strategic needs. We concluded that we needed a strategy of **focused growth** to beat our competitors – we needed to gain a competitive edge.

We also recognised that we had insufficient resources (in particular of finance and manpower) to enable us to achieve our ambitions organically and on our own. Our strategy was to be focused growth but even so we could not see our way on our own to filling the gaps in our expertise, even in our chosen areas of work. For us, merger was a means to build a stronger platform for growth.

Some of us also recognised that if we were to compete in the future, then we would need to change the ways in which we operated and we saw merger as a potential catalyst for making certain changes happen more quickly.

How did your merger come about?

We decided to initiate a search for a suitable merger partner. We had had approaches before but always felt at a disadvantage because we were not prepared for such approaches which came 'out of the blue'.

What processes were used to decide whether or not an approach to you should be pursued?

Initially an approach makes you feel ‘wanted’. But we also felt suspicious, particularly of their motives:

- Why did they approach us?
- What were their motives?
- What did they want?
- What could they bring to us that we could not provide ourselves?
- What problems did they have which they wanted us to sort out?

However, we were open - minded about approaches, although of course it was necessary as soon as possible to verify that it was an approach worthwhile pursuing.

We also looked at them very hard to see if there was a ‘culture fit’ – what kind of people were they? And initially we also looked hard at whether there was a business case and whether they had a vision – what could we do together?

We also had our own criteria for merger targets (see below) and while we were always prepared to look at something interesting and profitable, we did not want to be diverted from our basic strategy of focused growth and go off at a tangent, because we had a clear idea of the focus our firm wanted to build. We needed to balance out ***Strategy Vs Opportunity***. We found out that almost always (whether targeting another firm or being approached) there was some divergence and a preliminary judgment as to such divergence at the initial stage would often need to be made. The perfect firm is unlikely to exist and there will always be some compromises, which as long as they do not take away the basic reasons for and validity of a merger can often be satisfactorily managed.

We decided that we would only take approaches further and involve the partnership at that stage if those of us responsible for running the firm were satisfied on these four areas:

- OK people?
- Our fears were allayed as to motives;
- There was a vision and business fit; and
- Did it meet (or substantially meet) our criteria?

However, we were rarely approached by firms who ticked all these boxes. In particular it seemed to us that firms approaching us had not prepared themselves for the discussion and had no plan as to what a combined firm with us could achieve. We decided not to make the same mistakes.

What process did you use to select merger targets?

First and foremost we decided on **our criteria.** We were feeling quite positive about the future, even though we recognised we needed merger if we were to develop the firm as we wanted. This led us to be very clear as to our criteria for merger targets. We were not prepared to merge for marginal benefits – we were looking to make a quantum leap.

Our criteria

-Vision

First, we developed our own ‘vision’ of the kind of firm we wanted to create and this suggested some clear criteria for the type of firm we were seeking as a merger partner:

- Size / relative sizes and strengths
- People / reputation
- Business fit
- Financial case – relative profitability / debt and balance sheets

-Competitive edge

Would merger with this firm put us in a better position to take advantage of opportunities or create better opportunities in the market place of the future so as to give us an edge over our rivals? In particular:

- Would it improve our client service in terms of depth in our chosen specialisms and by filling gaps? Would our clients recognise that it would be good for them?

- Would it help us to stand out from the crowd by
    - Creating meaningful points of differentiation from our competitors?
    - Helping to create a better reputation and ‘brand’?
    - Provide us with more market credibility?
    - Help us to build more market share / dominance in our chosen areas?

- Would it help us to retain, increase and improve our client base, for example by
    - Obtaining better quality, more profitable work and clients?
    - Gaining increased penetration into core client types and industry sectors?
    - Extending our geographic reach in a way which benefits us?
    - Prevent client losses to larger firms with a ‘bigger name’?

- Would it help to improve our quality and substance in relation to
    - Management and infrastructure?
    - Access to more capital for investment?
    - Improving recruitment and retention potential?
    - Management of our risks

- Last but not least, would it improve profitability in the medium to longer term by
    - Economies of scale?
    - More efficient use of people?
    - Better leverage and / or rates?
    - More premium fee income from better quality work?

How did you then go about finding a suitable merger partner?

Good research is all-important. Do not believe your own 'market knowledge' or perceptions of another firm. You should also not necessarily believe what other firms say about themselves. Many just have good 'PR' machines and the public information available is not always that accurate. We did our own homework with the help of professional advisors with a view to knowing as much as possible about the firm and the personalities in the firm.

Based on our research we rehearsed answers to questions we thought they might throw at us at a first meeting, for example:

Why have you approached us?

We can see what we could do for you but what could you possibly do for us?

Why should we consider merging with you?

We don't need to merge but there is no harm in hearing what you have to say!

However first, we had to get them to the table and we did that by my picking up the phone and speaking to their managing partner (whom I had not met before) and explaining very clearly that we had targeted his firm as a potential merger partner and that we wanted to meet to explain our reasons for this. This approach had worked with other firms and it worked on this occasion.

We had to 'sell' the vision very hard when we met because all the questions we had rehearsed and others were thrown at us by our eventual merger partner.

From our side we also had to consider their motives for being receptive to our approach and whether having met them, there really were 'culture' and business fits.

At the end of that first meeting both sides agreed we should meet again. One lesson we had learned from others who had been involved in merger discussions was that it is important to keep the momentum of the process going. We therefore made sure that we agreed on the date of the second meeting before we left and we did that with every subsequent meeting to keep up the momentum.

Next month we will continue with this merger case study, looking at how detailed discussions proceeded and in particular how potential ‘show stoppers’ were resolved.