

PETER SCOTT CONSULTING

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Managing the merger process – to make it happen

In last month's Briefing Note we looked at why law firms, because many lack the necessary resources to develop *competitive advantage* on their own, are increasingly likely to need to merge. This, as recent media reports of some current merger activity illustrate, applies to firms across the size spectrum and is not limited to small firms.

Small firms do however, unlike their larger brethren, have particular problems which they must sooner rather than later get to grips with. In particular, many lack the most basic support infrastructures to enable them to satisfactorily manage their risks, their compliance obligations and their financial performance. And, with the advent of ABSs only a few months away, their need to develop their competitive edge becomes ever more urgent.

However, even though there is much talk of mergers, managing partners will tell you that many merger discussions are not going beyond an initial chat, while others are falling away before agreement can be reached.

Negotiating a merger needs to be understood as a *process* and in this Briefing Note I set out some thoughts developed over a number of years from being involved in merger discussions and which may assist you in negotiating your merger to a successful conclusion.

Do not to fall at the first fence!

You may have drawn up a shortlist of merger target firms which you have researched, possibly using various criteria such as 'compatible cultures', reputation, strategic fit, market positioning or size. You may then have arranged a meeting with your No.1 target on the shortlist.

At that first meeting you are likely to have no longer than an hour to make an impact and to sufficiently enthuse and excite the leaders of the other firm with the idea of merger with you, that they will want to take the matter further and arrange a follow up meeting for more detailed discussions.

To do this you will first need to have carried out sufficient research into the other firm and the market places in which you both operate to enable you to present a clear and coherent *vision* for a new firm which you could together build. You are likely to have only one shot at this and so preparation is vital, both in respect of the business case you put forward and your communication skills.

You may well be asked searching questions by the other firm which you will need to be well prepared for:

"Merger is not currently on our agenda, so why do you think a merger with you is something that would be of interest to us?"

"We can see what we can do for you, but what can you do for us?"

“How will a merger between our two firms make the resulting merged firm more competitive than we are currently?”

Doing in-depth strategic research and analysis of the market *before* you meet is likely to pay dividends.

Given the current legal market and the challenges now facing many law firms, your merger proposal may possibly be received by some firms more positively than would have been the case in the past, when many firms considered they did not need to do anything. Many now realise they have to seriously plan for the future because to do nothing is not an option.

If handled well, this initial part of the process, *developing a shared vision*, may lead the two parties to arrive at certain realistic conclusions as to the direction in which the two firms should be heading. This may point clearly to merger between them as an optimum route for both. On the other hand, the initial meeting may show one or both firms that merger (at least between them) would be a mistake.

As part of this vision / strategic planning process, it is important to look beyond what each firm now represents and instead, consider what the two firms *together* could build for themselves. Developing and communicating such a vision, to take the partners in both firms with them, is one of the most important roles the leaders of both firms will need to undertake throughout the merger discussions, as well as subsequently to ensure the merger is successfully implemented.

Culture

That first meeting is likely to put the spotlight on the culture (attitudes and behaviour) of the people in each firm, perhaps leading to a view that the respective cultures are compatible and the partners of each firm could work well together. On the other hand, it may show clear differences in behaviour and outlook between the two firms. This in turn may lead one or both firms to look in the direction of other firms which are perceived to have a more compatible way of thinking and doing things. However, perceptions, when it comes to law firms are often inaccurate. To properly judge what people are really like can take a long time and unless you have known and worked with them in the past, perceptions may be flawed.

Ask yourself questions such as:

‘Can we see ourselves working with them?’

‘Do they have the same work ethic as we do?’

‘Are we like them?’

‘Do we like them?’

If you have any doubts – it is probably best not to proceed.

Culture (and fear) within a firm may also dictate that a merger with a larger firm (or even a firm of equal size and strength) cannot be contemplated – only a takeover of a smaller firm will be considered. Despite there being a sound business case for merger with a larger firm, if the emotional instincts of the partners, perhaps driven by fear or a need to control, are saying ‘No’, then it is probably best to forget it, however good the business case may be. Much will depend on what is really driving merger thinking, which may be need, opportunity or ambition, or all three!

However, having said that, in these more challenging times firms may now be prepared to be pragmatic and realistic about merger opportunities and consider possible mergers which would have been unthinkable for them in the past.

On the other hand, if the leaders of the two firms do not look at the world in the same way, then again it is probably best to forget trying to bring together the two firms. But if the two leaders (leadership will be vital to the successful conclusion of merger negotiations and the implementation of a successful merger) share a common vision for building the new law firm, then their partnership is likely to be a particular strength.

If however it is clear from the beginning that both leaders are determined to be 'top dog' in the new firm, then their rivalry may become destructive. It may be better to recognise this at the outset rather than to spend many months negotiating and then have the discussions fail because neither will give way to the other.

If the leaders of both firms recognise the need for change in one or both firms, then that itself may become a strong driver for the merger to be used as a catalyst to make change happen. Sometimes a merger is the only way to bring about certain necessary changes:

'How are we together going to stop our best partners from leaving?'

'How are we together going to persuade our partners that they should agree to be managed and be accountable?'

'How are we together going to develop a culture in this firm whereby partners put the firm's interests first before their own personal agenda?'

'How are we together going to fairly match reward to contribution in the new firm?'

'How are we together going to manage performance to enable us to compete with firms which are currently better resourced and developed?'

These issues and others are likely to require fundamental changes in behaviour and attitude to be brought about in many firms, which given barriers to change which currently exist in some firms, are unlikely to happen easily or quickly. However, in a merger situation, *people expect change to happen*. Firms should think about the changes they have for long been trying to bring about, but which have in the past been blocked by certain partners being unwilling to adapt to change.

It is not necessarily a reason to merge, but using the opportunity merger may present to bring about necessary change can be a very beneficial by-product of a good merger.

Develop a strong business case

Merger is not a strategy - it is a means to an end, which is to gain competitive advantage. This is the strong message that you will need to communicate at that first meeting.

A tested business case for both firms will then need to be developed. To do this, the firms should put themselves into the position of their clients, because to be successful, a merger will need to deliver to the merged firm the ability to add value to clients more than its competitors. Satisfied clients are the only true test of a successful law firm.

'Will our merger have the 'Wow factor' for our clients?' - as in 'Wow, that will be good for us!'

The requirements of clients are continuously changing and clients are constantly demanding more and better 'added value' from their lawyers. Law firms must in turn adapt, grow and develop if they are not to be outgrown by their clients, potentially leading them to move to competitors who are able to provide them with the levels of quality and service they expect.

To successfully add value to clients and gain competitive advantage in the challenging legal markets of tomorrow, will require law firms:

- to provide their clients with what *they* need in terms of advice and service;
- at prices which their *clients* perceive as 'value for money'; and
- do this better than their rivals.

If you are considering merger, will merger enable you to create the 'Wow factor' and add value to your clients in this way?

In particular, will the merger help the merged firm to win more and better quality work from existing clients and new work from potential clients that neither of the legacy firms could hope to win individually?

In short, will the merger help to make the merged firm more competitive in its chosen markets than either of its legacy firms could have achieved?

It will also be necessary to factor in some other 'drivers of change' which can no longer be ignored by law firms:

- Will the merger enable the merged firm, with its greater resources, to afford to recruit skilled professional people to manage the risks and compliance now required in law firms? Perhaps more to the point, law firms should ask themselves the question "*Can we afford not to?*"
- Will the merged firm (with greater partner numbers and resource) make the firm more attractive to the professional indemnity market, particularly if it is seen to take steps internally to manage risk in a more effective manner?
- Will the merger help the new firm to recruit and retain good people better than either of the legacy firms have been able to do?

Develop a strong financial case

A merger based on a strong business case, if well implemented, should help to build greater long-term sustainable profitability. However, in the short-term, it is important also that a merger gets off to a good financial start, so that partners quickly realise the financial benefits that bringing together the two firms can achieve. Mergers and the lengthy negotiations which often occur, with their inevitable disruption, can be a dangerous time and there will need to be even greater effort devoted to planning and managing the new business and in particular to managing the financial wellbeing of the new firm to ensure that cash flow remains strong and that profitability does not dip.

Merger should not only be seen as an opportunity to build strong cash flows and revenues to drive up profitability, but also as an opportunity to strip out of the business substantial duplication and costs. Many firms have invested in support infrastructure capable of servicing a much larger firm. This can provide scope for rationalisation and efficiencies of

scale to match the overheads to the needs of the merged business. A merged firm ideally should not need two of everything. Start off as you mean to continue and let zero based budgeting become your mantra!

And if overheads are to be addressed then do not overload a merged firm with underperforming partners who are passengers! A question which will need to be asked by both sides at an early stage of discussions is:

'How many equity partners are you going to bring into the merged firm?'

One of the worst kinds of merger is where two firms simply put together their two existing partnerships, each heavily laden with underperformers, to create a larger version of what each was before, but with double the problems, so that $2 + 2 = 3$ (or less)!

How will the new firm be managed?

The quality of leadership and management skills available internally to fully implement the merger to enable it to achieve its objectives should be considered as one of the key requirements before proceeding.

Do we have a management team capable of successfully integrating and managing our new firm to achieve our common goals?

If there is no management team capable of achieving the visionary goals held dear by both sides, then there will be a large question mark placed over the ability of the merger to deliver on its promises.

The 'top team' will need to be identified at an early stage and partners on both sides should give their full support to the new team, if they wish to give themselves the best chance of success.

It is often said that the hard work really starts once the merger agreement has been signed. Implementation of what has been agreed is the key to a successful merger and failure to do this is why many mergers fail to live up to their initial promise. And it is vital to make sure that all important matters are agreed beforehand because if things are left unresolved in the hope they may get sorted out later, then reactionary forces may subsequently prevent a merger delivering its promises.

The leaders of both firms, even before they have concluded negotiations, will also need to agree on how they are going to deal with any major issues and then make things happen:

'How can we learn from each other?'

'How can we incorporate the best of our respective firms into the new firm?'

How are we going to make the changes necessary to ensure our new firm becomes a more competitive and profitable law firm?'

'How are we going to manage performance in the new firm?'

Law firms are people businesses and many of the tasks involved in negotiating and then bedding down a successful merger require the hands-on, face to face approach by the leaders of each firm. This will require the devotion of a great deal of time, effort and hard work. The 'learning curve' just gets steeper day by day!

Communicate, communicate, and communicate!

Throughout the merger process it is vital to communicate your messages, internally and where appropriate, externally (although always bearing in mind that whatever you communicate internally is likely to also be externally broadcast).

'Will our partners / staff and the marketplace / clients give us the 'thumbs up?'

And merger is a time of insecurity for many and of ambition for others.

'What will it mean for me?'

The better you are at communicating to everyone what is happening and why, then the greater the chance you will have of taking your people with you. To successfully merge and then integrate two firms will need constant communication, because however good the business case, it will be to no avail if it is not effectively communicated to the partners, staff and the marketplace.

In particular, communicating externally is vital if your clients and the market (including potential recruits) are to be persuaded that the merged firm will be good for them. Your future ability to recruit the best is likely to depend very much on how you project your merged firm in its markets.

Law firm mergers, both during negotiations and post-merger, have to be worked at very hard. Firms can give themselves a better chance of delivering what has been promised if they never lose sight of their vision – to build a more competitive and profitable law firm.

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