PETER SCOTT CONSULTING

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Will you be an 'acquirer' or a 'seller' in 2019?

Before reading this Briefing Note, consider the questionnaire below which may help you to clarify your thinking regarding some of your firm's strategic options and in particular, whether you should consider *consolidation* as a means to helping you to achieve your goals?

CONSIDER YOUR NEED TO CONSOLIDATE	YES	NO
To future proof your firm		
Are your existing strategic plans realistic and achievable within given timescales?		
Alternatively have you concluded that your firm will not be able to achieve its realistic strategic goals **on its own**?		
Are there potentially any profitable markets, areas of work or sectors which you have concluded your firm will not be able to access **on its own**?		
Is your firm currently **in the right place** in relation to its strategic aims?		
Can you ensure your firm **will be in the right place** in 5 / 10 years' time?		
Do you currently have **the right people in the right places**?		
Has your firm clearly identified **the risks to its future**?		
Does your firm need to **diversify** the services it offers?		
Does your firm have clients who individually each represents more than 5% of turnover?		
Is your firm on a client's panel which is regularly reviewed and where that client represents more than 5% of your turnover?		
Do you know how you are perceived in your market place compared with your competitors?		
Has your firm been unable to retain or to recruit people you really wanted?		
Is your firm finding it difficult to 'stand out from the crowd' and create meaningful differentiation from its competitors?		
Have you lost valued clients and good people to firms which are larger and more developed than your firm?		

Have clients or referrers told your firm that there are gaps in its service offering?		
If so, is a lack of resource preventing your firm from filling those gaps?		
Has a client ever used a competitor firm in preference to your firm because your firm was not considered by the client to have the necessary expertise or resource base?		
Has your firm failed to win work from clients which work was instead won by firms which are larger and more developed than your firm?		
Does your firm have a clear, achievable and fully resourced plan to plug any gaps in your ability to provide clients with what they will require from you in the future?		
Will your firm be able to afford to fully resource its future management and infrastructure needs, including - Leadership? - Finance? - Business development? - Risk and compliance? - HR? - Technology? - Knowledge?		
Will your firm be unable to improve profitability because it lacks economies of scale and efficient use of people or other resources?		
Are there any **changes necessary** in your firm which currently cannot be implemented?		
To deal with succession issues		
Have you recently reviewed the age profile of the partners in your firm?		
Is succession an issue for you now, or will it be an issue for your firm in the next 5 years?		
If so, do you have a plan?		
Have you identified younger partners who will be capable of or willing to take forward the firm in the future?		
If not, do you have a contingency plan in place?		
Have any of your partners said when they wish to retire or wind down?		
Do you have a compulsory retirement age for partners?		
As partners, do you think you have something to sell?		
If you consider there is ‘value’ in your firm, do you have a plan to extract that ‘value’?		

If you are a sole practitioner, is buying run-off cover and closing down your firm a practical and affordable proposition?		

Future Proofing your Firm

Identifying that *'something'* which will enable a law firm to build its competitive advantage over rivals is the ***critical task*** and the questionnaire above is designed to make firms focus on that issue.

Future proofing a professional firm should aim to **maximise owner value**, **reduce risks** and **create competitive advantage**. The focus should be on those things which will be future drivers of competitiveness and areas identified as risks to the business. A firm's people are its greatest asset but also arguably comprise its greatest risks. By aligning future strategic focus with managing people risks to ensure ***the right people will be in the right places***, a firm will be better able to secure its future competitiveness.
Markets are changing fast and only by continuously questioning the validity of the status quo and adjusting as necessary will firms be able to successfully respond to the powerful forces impacting on their businesses. Doing nothing cannot be an option in today's aggressive and ever more competitive professional services markets.

Strategic planning for a firm's future direction and growth requires continuous research, analysis, planning and decision – making – **and is client driven**.

The most valuable input is likely to be objective feedback from the key market participants that matter most in a firm's current sphere of operation, or where it is considering extending into. This will require a firm to ***listen*** to, not only existing clients, but also prospective clients and those who regularly refer work to it. It is becoming less and less relevant how firms see themselves. The objective in seeking such feedback will be to indicate the nature and required levels of its future performance if it is to successfully compete, by:

- providing input into its strategic thinking with a view to expanding what it provides to, and the share of business it wins from its current clients;
- ascertaining how it is perceived by clients, referrers and the market place;
- identifying any clear requested improvements or gaps in its capability against what its market needs, both currently and in the future, or what competitors are providing;
- identifying any significant strengths and weaknesses against relevant competitors;
- indicating levels of client awareness and receptivity to current services and how these may need to change;

Such feedback is likely to identify what drives ***client satisfaction*** levels and ***choice of law firm*** and if a firm can focus its efforts on these fundamentals then it is more likely to outperform rivals. Key findings are likely to include in particular:

Lack of Resource

Clients perceive that many firms are lacking sufficient resources to compete with their larger and more developed competitors. Moreover, feedback from clients and referrers in response to surveys often reveals there to be a clear distinction between the kinds of work they would give to a particular law firm, and what would go elsewhere. Reasons for using another firm often include the following:

- *specialist expertise or knowledge not available at the firm;*

- *larger deals go elsewhere where greater resources are available than are perceived to be available at the firm;*

- *The 'IBM' factor, particularly where outside stakeholders are involved and the reputation of a 'bigger' name is needed for reassurance*

Feedback such as this highlights the ability of larger firms to develop ***greater resource*** and to win work and, as a result gain a competitive edge over firms with less resource. However, even some of the very largest firms recognise their need to develop greater resources if they are to remain competitive in global markets and this is driving consolidation internationally.

The issue of resource is a particular problem for firms in what might be called the ***'squeezed middle market'*** which are often too large and lack sufficient focus to be niche but are too small to compete with their larger, more developed and better resourced rivals. Such firms should not attempt to be all things to all men. Being focused on growing a limited number of areas of work or sectors at which they are good and for which they are known, is likely to be a more sensible and successful way forward in the longer term.

Areas where resource is critical include:

- **Depth of expertise**

In today's highly competitive legal markets, having sufficient breadth and, importantly, sufficient ***depth of expertise***, requires building teams in focused areas. If clients or referrers perceive a firm as lacking the depth of expertise to compete with larger rivals then they are likely to migrate to those larger firms.

- **Management and infrastructure**

Firms require a minimum level of management and infrastructure to be able to operate efficiently, profitably and compliantly. Too many firms are still unable (or unwilling) to spend what is required to meet a minimum level of infrastructure to support and enhance their businesses in areas such as finance, technology, training, knowledge, HR, , risk and compliance and business development. The smaller the firm, the greater proportion of its income will need to be spent on providing for management and infrastructure.

- **Strong financial resource**

To provide that focused resource of expertise, management and infrastructure will require strong financial resource which will need to be invested in those areas where it can be most successfully and profitably utilised.

However, the investment required by many firms to achieve competitive levels of ***client satisfaction*** and ***preferred firm status*** is likely to be beyond the financial resources to which many partners are able or willing to commit.

Organic growth, while an attractive option for some, can devour large amounts of cash and depress the profits of a firm for a long period of time before the 'investments' begin to provide pay-back, and can never be guaranteed. There needs to be a balance between *'jam tomorrow'* and sustainable profits going forward at a level which ensures a firm is sufficiently competitive to recruit and retain the best people. This balance is difficult to achieve when there is a heavy investment programme in organic growth which is stretching the financial resources of a firm.

On the other hand, it is now increasingly common for firms which have listened to their clients, to conclude that not only do they currently have insufficient resources to achieve their ambitions but they also realistically recognise that ***on their own*** they will not be able to build such resources over an acceptable period of time or at an acceptable economic cost to their partners.

Scale is therefore required if stronger resource platforms are to be developed. This becomes the genesis for considering consolidation as a means to achieving a competitive edge over rivals.

An acquisition strategy

An *acquisition* strategy by which a firm will aim to acquire good clients, people and expertise to fill 'the gaps', from a number of smaller firms who may be looking for a 'lifeline' is currently for some firms a preferred option. A good place to start is to identify firms which have succession issues (see below). Firms will have their existing professional networks (banks, accountants, consultants, merger specialists, head hunters and recruiters etc) and these can be enlisted to help search for appropriate opportunities.

At the outset an acquisitive firm seeking opportunities should be clear as to its future business focus and identify firms it is prepared to look at with a view to filling gaps or building new areas of work to strengthen that business focus.

An acquirer is also likely to identify other criteria by which to judge a prospective target. For example

- What will it do for the firm in terms of acquiring quality people, enhancing reputation and building profitability?
- The firm's clients and the ability to retain and develop them profitably
- The people in the target firm, their wishes as to future careers and status and their remuneration
- The firm's claims record and how compliant it is with regulation
- What impact acquiring the firm will have on cash flow, both in the short and longer term?

A number of targets may need to be looked at and if appropriate external help should be enlisted. A tested business case as to whether acquisition of identified targets could help to provide the resource needed to build a stronger platform for growth should be developed.

Consolidation based on a strong business case, if well implemented, can help to build long-term sustainable competitiveness and profitability.

Succession issues

The current legal market is excessively fragmented to such an extent that around 80% or more of firms (with the exception of many niche players) are too small to be viable and to compete effectively.

Many small firms are facing the prospect of the retirement of partners, some of whom may have been the driving forces behind their firms in the past, creating the dilemma of how to replace them (and their capital) to secure the future. The dilemma is worse for sole practitioners who, when facing retirement, have even fewer options.

In some firms partners or sole principals have put their heads in the sand and hope the problems relating to succession will just go away. Sometimes this may be because there is not the knowledge or the skills to deal with the problems. Whatever the reason, such issues do need to be resolved because not only do they not go away but can become more acute as time passes.

How should a small firm or sole practitioner approach dealing with succession?

Options may possibly include:

- Continue the practice by taking in / handing over to one or more other partners, if there are available candidates willing to continue the practice on an agreed financial basis which accommodates an outgoing partner. However, there does seem to be more aversion to taking on risks these days on the part of many younger people and so increasingly partners who would like to retire are finding that this option may not exist. The risks are often perceived to be greater where the clients are concentrated around the retiring partner and where there has been no effort to organise an orderly hand – over to others.

- Close down the practice, with the costs of run – off cover associated with this route, which may make this option unattractive.

- For some sole practitioners who cannot afford to or choose not to buy run – off cover, this may mean continuing to work while running down their practices to a level of turnover which will make run – off cover more affordable.

- Finding another firm to sell to or to join as the realisation grows that the only sensible option may be to throw in their lot with others.

In this note I will focus on the last option above - joining with another firm because ***'one firm's succession problem may be another firm's acquisition opportunity'.***

Partners in small firms or sole practitioners with succession issues should ask themselves some hard questions -

Do I have a business which another firm is likely to want to acquire?

Acquisitive firms are likely to be seeking to add to the existing skills and expertise they already have or to create new areas of expertise. Sole practitioners or partners in small firms should therefore work at building competitive focuses to their practices which are going to be attractive to other firms. By their nature many sole practitioners and small firms already have quite focused and profitable niche practices. In particular, if a firm's practice is -

- in an area of expertise currently in demand and where there is likely to be sustainable growth in the future,

- which another firm needs but cannot itself provide or grow easily, quickly or at an acceptable economic cost

- which is delivering rising profitability on a sustainable basis from a stable and growing client base

that firm is likely to be **an attractive target and may well have something to sell**.

This is about ***picking winners*** and is likely to require forward planning perhaps five or even ten years in advance to ensure that a firm creates something which will have a value and can be sold. This is not a pipedream – there are many examples of small niche or boutique law firms which have realised their value by carefully preparing their businesses for sale in this way.

On the other hand, small firms with a mixed bag of unfocused and not very profitable work are likely to struggle to find anyone to take them on.

If a firm is in this latter category then it should take a hard look at itself to see how it can make itself more attractive to a potential buyer –

- perhaps there is an area of work which serves no useful purpose and loses money or burns cash which the firm should close down or dispose of, which would then sharpen the firm's focus and make it more profitable and financially stable

- if the profit trend is downwards and debt is increasing then more drastic measures are likely to be needed, not just to prepare the business for disposal but to enable it to survive and avoid insolvency or a 'fire sale'

Does my firm have a value?

This question can often be approached by looking at what a lawyer may have to sell –

- His or her services / labour? – these will have a price / salary in the employment market place

- There may be some 'hard' assets such as work in progress, debtors or a property which can be realised

- Or there may be 'goodwill', which is the difference between the net hard asset value and what a firm is prepared to pay for the business.

NB – in relation to valuation and to ensure you receive your value, always take good valuation, accounting, tax, P I insurance and legal advice.

Research the market

Whether you are an 'acquirer' or a 'seller' you will stand a better chance of finding what you are looking for if you thoroughly research the market. You can do this yourself or you can use a suitable third party experienced in this line of work.

I find that even in small geographic legal markets, many firms do not really know much about the other firms in that location and the work they do. They often have 'perceptions' but rarely any hard knowledge about a firm and its business.

You may have drawn up a shortlist of 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 other firm with the idea of getting together with you, that they will want to take the matter further and arrange a follow up meeting for more detailed discussions.

As emphasised above, to do this you will first need to have carried out sufficient research into the other firm and the market place in which you both operate to enable you to present a clear and coherent vision for what 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. For example:

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

"[Sale / acquisition / merger] is not currently on our agenda, so why do you think getting together with you is something that would be of interest to us?"

"How will putting our two firms' together make the resulting firm more profitable than we are currently?"

Doing your in-depth strategic research and analysis of the market and the target before you meet is likely to pay dividends and will enable you to give a message to the other party that you have done your homework and deserve to be given a hearing.

If handled well, this initial part of the process, to develop 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 their getting together as an optimum route for both. On the other hand, the initial meeting may show one or both firms that doing so (at least between them) would be a mistake.

As part of this process, it is important to look beyond what each firm now represents and instead, consider what the two firms together could build for themselves and the potential benefits which could accrue to both parties. Developing and communicating these messages are some of the most important things that those running the two firms will need to undertake throughout discussions, as well as subsequently, to ensure *the deal* is not only concluded but is successfully implemented to achieve both parties' objectives.

Whether your firm is a potential acquirer or seller, it should put itself into the position of its clients, because successful consolidation will above all need to be good for clients and meet the clients' ''wow" test -
"***Wow. That will be good for us"***