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10 Critical Challenges in Negotiating a Successful Law Firm Merger

By **Blane R. Prescott** | July 19, 2018 at 08:35 PM

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There are a number of well-publicized studies by the leading accounting and consulting firms that have found 70 percent or more of corporate mergers failed to achieve their goals or even generate a return to shareholders. It isn't surprising, then, to learn that law firm mergers have a similarly low success rate. But why? How do law firms go astray, and what can leaders learn from highly successful law firm mergers?

Many lawyers assume mergers fail primarily due to implementation problems, after the merger has taken place. While implementation issues are challenging and pervasive, the real problems are fundamental flaws with the deal itself, which get hidden by the traditional corporate merger negotiation and due diligence process. The following is a summary of the most common, but not commonly understood, problems in analyzing and structuring mergers of law firms.

1. The Business Case

The single biggest failure is the lack of a realistic business case—the summary of meaningful, achievable benefits to be realized through the merger. Overwhelmingly, the average law firm routinely overestimates the benefits a merger will produce. Why? Mergers sound sexy, seem bold, and are tangible proof of action by leaders in a profession often characterized by a lack of visible progress. But rather than analyze a combination through an objective, rigorous assessment of the benefits and drawbacks, too many firms get drawn into the excitement of merger negotiations and then rationalize a deal with a light analysis.

One common failure is that firms assume the merger itself will create value. But, as has been proven repeatedly, the mere structural combination of two firms achieves almost nothing by itself. The real test and questions leaders should be asking are:

- What will we do differently after the merger in order to be more successful? Just having more resources rarely means that you will use them effectively.
- Which partners will lead those efforts and be accountable for specific actions and specific results? Just as importantly, have those partners led similar efforts before, and demonstrated their success (beyond just developing a large personal client base)?
- In order to make this merger successful, are we expecting cultural shifts and behaviors that we haven't been able to implement before?

Many firms spend only a few hours analyzing the business case, without doing any real testing of the same, and thereafter just repeat slogans ("after the merger we will be a market leader in X" or "we will have the largest practice in the Y market") rather than planning meaningful client or industry penetration strategies. If one looks at the history of the profession, the lack of real planning isn't surprising: Law firms are often lightly managed, have benefited from a long-term sellers' market, and were successful more due to inertia and market conditions rather than developing and implementing new strategies. But mergers, especially in the rapidly evolving market, tend to create immediate competitive and integration challenges for even the best leaders. Those challenges show leadership's ability (or inability) to create real partner teamwork and accountability. Slogans are easy; successful merger integration is hard, messy and requires aggressive actions and real accountability.

2. Lost in Process

Another common problem in negotiating mergers is that firms conduct numerous meetings, exchange war stories and bounce from topic to topic, but make little substantive progress. If you have had this experience, it means you are normal. In some ways, law firm mergers are more complex and challenging than corporate transactions, primarily because the performing assets are all people. The numbers and hard asset side of a merger are easy; the people issues are far more complicated.

Law firm mergers require a different approach than a typical corporate merger. When done right—because firm leadership has followed a disciplined, methodical approach—some of the largest, most successful law firm mergers have been negotiated and structured in as little as four months. The longer merger negotiations take, there is an increased likelihood that the merger won't achieve its goals. If you don't have the benefit of prior experience in creating a successful merger, keep in mind four critical concepts:

- Identify and resolve the big issues first, so you don't waste months negotiating a merger that has no chance of success.
- Organize the discussions into three sequential but overlapping components: business case, deal structure (term sheet), and integration. Of those three, the business case and integration efforts will determine the success of the merger, far more so than the deal structure or term sheet.
- Keep in mind the one fact that separates mediocre deals from the most highly successful: Focus on the specific activities you will do together, and, wherever needed, acknowledge how those are different or more difficult than your past actions. Verify with clients whether they honestly see real value in your combination. If your integration teams keep talking hypothetically about what you could do, but don't get specific in terms of who/when/how, you are well down the path of creating yet another mediocre, underperforming merger. The worst combinations are almost always characterized by a lack of cultural and market position progression, and a lack of actual teamwork between predecessor firms.
- Don't be afraid to walk away. Too many firm leaders find themselves negotiating terms for six months, on a marginal combination, but keep pushing forward because they fear they will look foolish if they have invested too much time and don't produce a merger. If you handle the process right, bad deals should die after one to three meetings and die for all the right reasons.

3. Don't Put Off the Hard Issues

One of the most pervasive red flags in law firm mergers occurs when leaders run into a disagreement over a core philosophy issue and decide to run separate, parallel systems initially, and deal with the harder issue of integration sometime after the merger. Examples of this often include partner compensation, leadership, debt/capital, long-term strategy, partner performance standards and future investment priorities. If you can't solve major issues before the merger, then this is the best indicator you shouldn't be merging in the first place, or at least you should go back to the negotiating table and talk about what you are really trying to accomplish.

For too many firms, the negotiation of big issues becomes a juvenile argument of "if we use your structure on some issues then we get to keep some of our structures/policies/procedures," even if those make no sense and have a proven history of destroying teamwork. Bad firm mergers are characterized by structures chosen primarily because they were "the way we have always done things." Successful mergers provide firms with a unique opportunity to rapidly change and evolve, not just pick from the limited habits of their predecessors. Most successful leaders recognize and capitalize on this opportunity.

4. Conflicts, Conflicts, Conflicts

Most leaders understand that conflicts will be a time-consuming, difficult issue to resolve, yet most firms still fail to start the conflicts check early enough, or to deal with conflicts effectively. The simple rule of thumb is that once the business case is vetted, and you think you can come to agreement on the core philosophical issues, start working aggressively on conflicts. And no, just checking the top 100 or 200 or 300 clients isn't good enough. The history of law firm almost-mergers has a shocking number of great combinations that were killed at the last minute over a tiny, but unsolvable, client conflict. Or worse, actual mergers accompanied by the last-minute departure of great rainmakers who were forced out due to a conflict.

5. No Magic Beans

Mergers can be one of the best strategic moves law firms can pursue. But they rarely cure pervasive ills present in their predecessors simply by virtue of the combination. For example:

- The merger of two middle-market, midsize firms only creates a large middle-market firm, not a dominant market leader. Too many firms confuse cause with correlation when it comes to firm size or market position.
- Firms with a poor track record of cross-office cooperation and cross-selling almost always become a larger dysfunctional firm, rather than a highly integrated, well-functioning team. If your historic cross-selling efforts were largely instigated by your clients, rather than by your lawyers, the odds are you aren't going to capitalize on the opportunities created by a merger unless you face up to fundamental shifts in your culture.

Firms can merge and solve their problems, but that is only accomplished when talented leaders honestly confront the difficult aspects of their culture and behavior that have to change, because the merger or size alone won't do it for them.

6. Not Too Big, Not Too Small, Just Right

This issue isn't about the size of the combined firm, but rather the size of the committees negotiating the merger. There is a high correlation between dysfunctional mergers and negotiations carried out by a team of two or three leaders from each side. Likewise, there is a high correlation between never-ending merger discussions and merger committees each with 20 or more members. A core negotiating team of five to eight people from each firm, assisted by a number of critical, ancillary subcommittees involving other partners, working on issues like capital, associates, compensation and tax, has the strongest track record of success.

7. The 20 Percent Rule Has Been Muddied

Many leaders are familiar with the rule of thumb that says in order for a law firm merger to work, the profits per partner of the predecessor firms should be within 20 percent of one another. The underlying concept is still relevant, but the evolution in titles and roles has muddied the waters.

What is a partner? Do you count nonequity partners? What about your partners who are "special" cases (every firm has them)?

Rather than relying on a single number for this analysis, performing a slotting exercise in which individual partner performance and compensation statistics are slotted against similarly performing partners in the other firm is far more helpful. Admittedly, the exercise is relatively simple—what you then do with the results is more challenging. But this analysis can give a clear indication of the philosophical and performance integration challenges you will encounter.

8. Open Yourself Up

Admitting weaknesses is one of the hardest issues for law firm leaders to address, since it goes against human nature and most peoples' instincts about selling one's self. Spend dedicated time talking about all of your respective weaknesses, faults and problems, and do so honestly and openly with the other side early in the process. Leaders who hide or downplay problems create some of the most life-

threatening problems in law firm mergers. Firms are better off revealing those issues before the merger (even if it puts the deal at risk), rather than allowing them to be discovered post-merger.

Discovering critical problems post-merger is far more complicated than just fixing the problems themselves—the discovery creates distrust, prompts suspicions about the competence of leaders who led the due diligence efforts, and invariably creates fertile ground for partners to believe any and all rumors about the weaknesses of the other side. If you have never conducted an open, honest discussion of your weaknesses, get some help and invest the time to do so constructively. It may sound intimidating, but oddly enough, this one effort produces the strongest foundations for a successful long-term merger.

9. You Are as Well Known for Your Worst Lawyer as Your Best

Perhaps one of the most troubling lapses in the due diligence process is the failure to look at the reputation and quality of a potential merger partner. Lawyers tend to have strong, critical opinions about other firms and partners in the normal course of business. But too often, once merger discussions commence, everyone is suddenly a star. This may be due to the fact that no one wants to embarrass the other side by asking to look at their work product, asking about their weak or problem lawyers, talking to a cross-section of clients, or seeing how they routinely staff and manage a project. But firms are far better off asking sensitive questions up front than in finding out post-merger that their new firm does substandard work or has predominantly small or short-term clients because they don't service them well. Leaders shouldn't underestimate the persistent, long-term damage that will be done to their firm's reputation due to a lack of quality or service, even by just a few lawyers.

10. Lawyers Think Term Sheets; Successful Leaders Think Integration and Strategy

The adage that when you are a hammer all the world looks like a nail applies to law firm mergers. The average lawyer tends to think of the negotiation of a term sheet as the core of merger negotiations. While term sheets are important, they virtually never predict or create the success of a law firm merger. That is one of the reasons many corporate lawyers, who are extraordinary at generating clients and doing corporate deals, fail when it comes to analyzing and executing law firm mergers. In fact, one of the most common characteristics of weak mergers is that the bulk of the negotiations primarily focus on the term sheet, while real integration and business planning are largely ignored or left as post-merger considerations.

Law firm mergers are less like corporate deals (there are no meaningful assets being bought or sold), and far more like marriages. Yes, you can out-negotiate your future spouse. But just like a spouse, merger partners can and will walk away if the relationship doesn't work out and may do so even when it doesn't make immediate economic sense. The most successful law firm mergers are overwhelmingly characterized by a clear understanding and excitement about what they can achieve together. When firms argue over deal terms for months on end, or partners have to be incentivized to vote for a deal, it is often a sign that there are deep philosophical or structural differences that won't be overcome.

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The intent here is not to discourage law firm leaders from pursuing a merger. Instead, it is to encourage leaders to understand how to do strong, successful mergers, and not end up among the majority that fail to meet their goals (or worse, fail completely). Successful law firm mergers frequently produce extraordinary benefits almost immediately—literally within one to three months. And virtually all of the best mergers have occurred because great leaders weren't afraid to ask hard questions, to run a rigorous assessment process, and to face up to the difficult decisions that need to be made first about whether to merge, and then if appropriate, how to merge.

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