SUCCESSFUL MERGERS – Planning Strategy and Execution

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By Michael Simmons and contributors

SUCCESSFUL MERGERS
Planning, Strategy and Execution

Michael Simmons
and contributors

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Introduction

Nearly every professional firm is likely within the next twelve months to consider in abstract the possibility of merger, receive a merger approach, or actually merge. The present climate, both economic and professional, is such that we feel vulnerable on the one hand, while we worry about coping with the ever increasing workload on the other.

While merger consultants are beginning to appear, who will offer their services in advising on the practicalities of merger, our library shelves to date have totally lacked a work on this particular subject. This book is designed to fill that gap. It is designed essentially to be a practical work of reference and is in no way intended by the authors to be a legal text book in the accepted sense of the word, with the exception perhaps of Chapters 7 and 17 in those parts where Nigel Davey deals with the taxation aspects.

Solicitors and the members of the other professions are having to learn the hard way, but management is not an exact science. There are no hard and fast rules, but merely guidelines. Managers, unlike those perfect professionals, will make mistakes. This book is about guidelines and indications for those engaged, or likely to be engaged in the merger process. It is designed to be a helpful book based in part on the actual experience of its authors. We have endeavoured to balance the practical illustrations with the views and concepts of some of the more eminent consultants available to the professions on both sides of the Atlantic.

Having had the role of managing partner thrust upon me at an early age, the problems of growth forced me to seek solutions to the management difficulties, which my firm was then facing. Having had an academic background before becoming a practising lawyer I looked for academic solutions on the management side, but I found that the United Kingdom had little or nothing to offer me of use in the professional services sector. I was pointed in the direction of the Economics of Law Practice Section of the American Bar Association, and I have been making my annual pilgrimage to the United States ever since to sit at the feet of the great and learn from them. A lot of the success which my firm now enjoys, such as it is, is a result – on the management side – of what I learned in America. This applies to the science, if it should be called that, of mergers. The concepts of management taught by the Harvard Business School, among others, have been applied to law office management and the subject of merger has come under full scrutiny.

I commend readers particularly to chapter 1 by William C Cobb, the doyen of American legal consultants, the breadth of whose perception and original thinking is matched only by the vividness of his Texas ranching metaphors.

We have been singularly fortunate in the quality of those on this side of the Atlantic who have been persuaded, by fair means or foul, to contribute to the book. I have to mention specially Aubrey Wilson, who is recognised at the Harvard Business School as well as in the U.K., as the foremost consultant on marketing for the professional services sector.

Messrs Spicer & Oppenheim have achieved a particular reputation in the quality of the advice that they give professional partnerships, which is a subject which they seem to have made their own. We are extremely fortunate in having Nigel Davey as a contributor in chapters 7 and 17. Among a long list of solicitors contributing, I hope that he does not feel lonely as the only accountant.

Lynda King Taylor has made a special study of the treatment, good or otherwise, of personnel in professional firms, and she was an obvious choice to write chapter 10a on that particular topic. We have not been disappointed and the chapter in question offers a great deal of food for thought.

When Part 3 of the book was conceived, it was my private opinion that those solicitors approached for their personal views of their own mergers would adopt the traditional lawyer's attitude of silence and secrecy. I think that it is fairer to say that I was overwhelmed rather than merely pleasantly surprised by the total openness and co-operation, which I received from all those whom I approached. I am particularly indebted to Sir Max Williams for the Clifford Chance story, bearing in mind that he must be one of the busiest men in the legal profession. Not only did he deliver the goods, as it were, but produced it in absolutely record-breaking time.

Over the years, one makes many friends in one's own profession, and I feel that the total co-operation which I received in that section owes a lot to that friendship. Thank you, gentlemen.

Part 4 is designed once again as a practical section and is designed to show readers that the actual consummation of the merger is by no means the end of the road. A great deal of work still has to be done on a continuing basis to realise a 'Successful Merger'.

I make no apology for the fact that chapter 20 on the subject of de-merger effectively ends the book. In due course, I expect to see a number of books written on this particular subject alone. As the rush to merge accelerates, so the converse physical situation will arise, and there will be an increasing number of hive-offs, de-mergers, defections, split-offs, or what you will. For the moment, the subject has been restricted to one chapter only, but future experiences will, no doubt, impel an expansion.

I have tried to stress that this is intended as a practical book. The rights and wrongs of a merger appear after the event. The book is intended to guide readers through the process, but new situations and different experiences will occur all the time and will, I hope, form the subject of the second edition. I encourage you all to write to me with those experiences, even if they are at variance with what appears in this book.

Michael Simmons was educated at St. Paul's School and Emmanuel College, Cambridge. He qualified as a solicitor in 1958 being placed equal first in the Honours' List and was joint winner of the Clements Inn Prize.

After National Service in the Royal Air Force, he joined his present firm, Malkin Cullis & Sumption as the junior of two partners. He is now senior of twenty partners and concentrates on company and Commercial Law generally.

In recent years he has written, broadcasted and lectured on a number of legal topics particularly with reference to professional practice problems.

He is now specialising in advising the legal and other professions in relation to their problems of practice and is the author of "Anatomy of Professional Practice".

Part I

PLANNING THE MERGER

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1 Reasons For and Against Mergers

Over the past few years, many firms have contemplated mergers or acquisitions as a tactic to achieve their perceived goals. Unfortunately, merger, as an answer, does not usually fix the problem. In fact, many firms have difficulty defining the problems they are trying to solve. Such firms are using the "herd" method of planning. After all, if all the other firms are doing it, why shouldn't we? Cobb Consulting Group's experience indicates that, of the mergers and acquisitions Cobb is introduced to after a merger has been accomplished, eighty percent do not measure up to the expectations of the partners. Mergers and acquisitions, therefore, are not the answer for most of the problems firms perceive to be solvable through such a tactic.

Throughout this overview chapter the terms merger and acquisition mean the combination of a large percentage of two firms. Merger and acquisition are used interchangeably in that the approach is the same but the relative size of the two firms is different. Merger implies the combination of two fairly equal entities, and acquisition implies the combination of entities of unequal size. Another set of definitions would be:

Merger: A + B = C
Acquisition: A + B = A

Experience shows that most combinations are acquisitions even though the assets and resources of the two firms are pooled.

Why Merge?

Arguments for merger are many. Successful mergers and acquisitions are the result of firms doing their homework, defining a unique strategy and using the merger or acquisition tactic as the most viable alternative available to them. The most obvious reasons for using merger or acquisition strategies are outlined below.

Joint client strategies

The first major reason to merge or acquire is to take advantage of client development and maintenance opportunities. The merger or acquisition activity is a result of a well-developed strategy, not a knee-jerk reaction to the first apparent opportunity. There are three client service areas to consider: service to existing clients, development of new clients and geographic presence.

Service to Clients

The first goal of the merger tactic is to increase services to the firm's current client base. The firm's strategy should be to focus on the development of its current client base and to maintain a high level of client service. When this strategy is fully developed, the criteria for targeting and integrating another firm are established. The initiating firm then understands the tough questions that it must ask when proceeding through the pre-merger, merger, and post-merger phases.

Development of new clients

Developing new clients is a key reason for merging. This strategy uses the existing expertise and accumulated knowledge of the firms. Where the firms have found their current expertise could be more efficiently used with a higher volume of work, a merger or acquisition may be an appropriate tactic to acquire the clients that need the expertise of the joined firm.

Geographic presence

Another strategy is the expansion of a firm to gain access to clients through a broad geographic presence. This is a volatile and potentially risky strategy. Distant office locations may highlight inherent problems such as lack of synergy; cultural differences; significant differences between legal markets and the way a firm gains access to those markets; differences in the level of expertise required to practice in one region versus another and similar problems. The firm using the merger or acquisition tactic to expand geographically must have deep pockets and a real commitment to spending the hundreds of hours and actual capital required for integration of the two firms.

Utilisation of expertise

A second major strategy that drives a merger or acquisition tactic is the need for additional expertise to service the firm's existing client base. It is assumed that the acquiring firm has a realistic assessment of its practices and the services it delivers and has identified the needed expertise most critical to the viability of the firm. Having accomplished that assessment, the firm has identified those areas of expertise it requires and under what circumstances that expertise is to be acquired.

Capitalisation on the expertise of others

The primary purpose of going through the merger or acquisition negotiation is to communicate the expertise needed and to determine whether the target firm has that expertise. The group being brought in will perform best against the expectations of the acquiring partners if the expectations are clearly defined and discussed. It is better to communicate expectations before attempting to integrate than to find out later that the groups involved do not understand the expectations.

Increasing the representation of current clients

The merger or acquisition may be a strategy for expanding services to current clients of the firm. The merger or acquisition tactic should identify, assign and develop new areas of support through the added firm.

Two plus two must equal five

Merger or acquisition is a tactic employed as part of a firm strategy. Most firms will find, if they go through the planning process and develop a viable strategy, that a merger is not an appropriate tactic to solve their perceived problems or to move them towards critical opportunities. To be successful, the firm must be independently viable and have solved their internal problems. To make a merger work, two plus two must equal five. All the effort involved in making a merger work should, over time, lead to a better firm in terms of client service and partnership profitability. The following discussion focuses on the adverse consequences of 'not doing it right'. In order to 'do it right', the firm must adopt the operating philosophy of using the planning process to lay the foundation for the firm's future. Tactics such as mergers or acquisitions must be implemented in the context of the firm's overall goals, objectives and specific strategies that flow from the objectives.

Risks

The risks to firms involved in a merger or acquisiton are numerous and complex. Without a well thought out strategy that will legitimatise a merger effort, it is highly probable that one of the following adverse consequences will materialise.

Risk to the acquiring firm

The risks to the acquiring firm include the initial investment of time and money, playing the role of venture capitalist without control of the return on investment, and the increased complexity and pressure of managing a merger process.

Investment.

The firm must invest a great deal of time and money in the effort. This diverts resources away from clients and the firm's capability to generate revenues. Typically, the most valuable partners are involved in the effort, and, therefore are diverted from the practice of law and firm clients.

Venture capital with no 'Golden handcuff'.

The acquiring firm will be committing critical resources to the combination effort. The effort, however, may provide the target firm with clients and capital to establish itself in a market. If the firm acquired is in another city, the acquiring firm may be financing the other firm. When the acquired firm becomes self-sustaining, the practice is portable, and there is no need for the acquirer.

Seeds of spin off.

Every time a branch office is established, the firm sows the seeds of a new spin off. Even if the firm acquires a firm in its own city, individuals in the acquired firm may decide that the new effort is not to their liking and position themselves to leave. If these partners are key to the acquired firm's viability, their departure can have a disastrous effect.

Number and complexity of decisions.

The number and complexity of decisions will go up exponentially with the acquisition of each new partner. The combining firms must deal with complex problems of management, communication, coordination, effectiveness and cost of delivery of services. The key partners of the acquiring firm must begin to focus on the management of people who have not been inculcated with the traditions and culture of the acquiring firm. The operating philosophies and unique values of the acquiring firm must be continually communicated and reinforced by the mangement group with constructive discussions of how the two firms' cultures can be accommodated. Communication needs will increase dramatically as a function of the number of new partners. Not only must management position itself to listen to the partners, but it must also set up a more formal decision-making hierarchy to ensure that communications and resulting decisions are effectively actuated.

The combination of management and communication will drive the merger firms towards a more accountable structure. Accountability means that every partner must have a solid sense of his or her responsibility for functions such as client management; practice management; project management; section management; supervision; committee chairmanship and management. Accountability also assumes that the partners know their performance in assigned functions will be consistently evaluated and reflected in their share of partnership profits.

Suffice it to say that very few firms have reached a point where their management functions are effective enough to meet the above criteria. Therefore, they are not in a position to take on the complexities involved in a merger or acquisition.

Every firm that merges with a firm outside its own city is a little more realistic about coordination problems than are firms that are within the same city. If one of the combining firms has problems with coordination between practice groups and lacks efficiency in cross selling and cross support, the problems are going to be magnified by a merger. In reality, those firms that have a strong sense of direction; effective strategies operating within the firm before the merger and a sophisticated set of guidelines for using the merger or acquisition tactic are the ones that will succeed in integrating new personnel and practices quickly and effectively. Managing professionals must treat their combined firms with the same respect they give their most significant clients.

Given the coordination problems in the delivery of professional services, efficiency goes down, not up, when a new group of people comes on board. The combined firm must deal with integrating the new partners into the operating procedures of the acquiring firm, with delivery services and with passing work among the practice groups of both firms. More importantly, the new firm may not be able to use efficiently the informal networks of the acquiring firm for example in the referral between lawyers.

Owing to the inefficiencies discussed above, the economies of scale that firms think will be part of the delivery system in the merged firm will not mature for at least twelve to eighteen months. When expectations are too high, the partners become disenchanted with the merger and a 'we' versus 'they' attitude may begin to prevail.

Risk to the acquired firm

The risks to the firm being acquired are even more pronounced. Typically, the firm to be acquired is not blessed with the depth of resources of the larger firm and therefore must allocate already stretched talent to the effort. Key individuals will be distracted from vital client relationships and practice responsibilities. The firm may suffer a loss of identity in the market as the merger discussions continue and news of the potential merger leaks to the public. Discussions with the acquiring firm may cause some partners to envision a new firm they do not wish to be part of and precipitate an exodus. Also, the acquiring firm may not want all of the partners of the target firm. Finally, the integration of the partners into the new firm may upset some old partner synergies and referral networks developed over the years, thus magnifying some of the acquired partners' insecurities.

Distraction.

When negotiating a merger, the partners who are part of the acquired firm's management group will be time pressured. These partners are usually key to current important client relationships, lead the practice groups and participate in the mangement of the firm. During the merger discussions, critical daily mangement functions may fall through the cracks endangering the firm's viability. If the negotiations fail, the ability of the minor firm to hold key clients may be endangered. The competition will certainly use the failure of the negotiations to their advantage in establishing footholds with key and significant clients.

Loss of identity.

As the firm begins to negotiate with the potential acquiring firm, the internal identity of the firm may suffer. If the acquired firm does not have a strong consensus on its direction, its market niche, culture, shared values and negotiations will constantly be coloured by the perception of the acquiring firm. All the values of the old firm become suspect, and the firm may begin to flounder even before the merger negotiations become serious. Should the discussions break off, the firm could be subject to some very tough times. Discussions held in the merger-failure environment may drive the firm members apart. With a strong sense of direction and consensus prior to merger discussions, negative consequences are less likely to occur.

The firm may run the risk of irreparable damage being done to its client market share. As competition and clients get wind of the merger, questions will begin to surface about the underlying changes in the firm. Clients start asking if the new firm will be less responsive and more costly. The competition may comment that the firm is in trouble and needs to be bailed out. The firm's significant clients will become opportunity targets for aggressive competitors. Should the merger fail, the firm may be stuck with the image that it could not be bailed out or that it was not good enough for the acquiring firm. A failed merger is thus almost a no-win situation for the non-acquired firm.

Break off.

As the culture and operating philosophy of the acquiring firm becomes clearer, some key partners may decide they do not want to practise law in the perceived new environment. These partners may either stonewall the merger, adopt an attitude of quiet resistance or start to place themselves with other firms.

Break up to old synergies.

Assuming the merger goes through, the new partners will have to be integrated into the acquiring firm. As the new partners are integrated, old ways of allocating work, methods of practice and office procedures will change. This will be uncomfortable for some patners and may amplify their sense of insecurity. The new partners must learn to operate in a large firm environment where accountability for client management, allocation of work, management of projects and firm management will be more structured and place greater burdens on partners. The pressure of the new environment and the performance standards may constructively isolate and eventually force out some of the acquired firm partners.

Messes

Law firms seeking to merge or be acquired not only run the risks discussed above but compound their problems by taking a casual attitude towards the merger by assuming that once agreement is reached in principle everything will work out and they can go back to practising in their traditional manner. This is not the case, as decisions made 'up front' must be implemented. The most difficult part of a merger is its implementation. The better the preparation and process for negotiating the merger, the more effective and efficient the implementation will be. There are many opportunities in mergers for wishful thinking. There are also many pressures for taking short cuts in the process. Many examples of disasters can be cited when wishful thinking and short cuts were involved in the negotiations.

Summary

The combination of two firms is a difficult process but one that can be accomplished if the firms have properly prepared themselves before finding one another and if both firms have taken a concerted and objective approach toward pulling the two firms together. It is crucial that all preparatory time involved on behalf of both firms is aimed at ensuring the integration of the two firms by the end of the first twelve to eighteen months of operation. Once a merger agreement is signed, it is not a contract that will enact itself automatically. It requires a tremendous amount of work and commitment from every partner within both firms. Given the nature of professional practice and the pressures on professionals today from clients and competitors, it is the exception when two firms will take the time and effort to prepare themselves adequately and conduct themselves in proper sequence for negotiations and implementation.

Mergers or acquisitions are not appropriate for most firms and there will always be niches for small and medium sized firms. A firm cannot represent all clients and cannot be all things to all people in the current competitive environment. Firms must have a strategy and take actions based upon that strategy. A merger or acquisition may not be an appropriate tactic for your firm, but, if it is, do it right.