Ward Bower

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Is This Merger a Good Idea?

By Ward Bower

Continuing consolidation in the legal profession means that ever more firms are being approached as merger candidates or acquisition targets. Many firms instinctively reject such overtures, especially when things seem to be going well. Others feel an obligation to explore every opportunity that presents itself, with great cost in terms of time, energy and out of pocket expense. After all, such an overture may turn out to be a once in a lifetime opportunity. And if we don't consider it, what could happen if a major competitor were to be approached next and do the deal? How do we decide whether we should seriously consider a merger approach, minimizing the risk of foolishly rejecting a golden opportunity without entering into a quagmire or an outright disaster? Consider the following.

First of all, merger should not be a goal in itself — it is a strategy to achieve some greater goal or objective that results in or amplifies a *competitive advantage*, which occurs when a business becomes more stable or profitable — generally via more or better business, clients, and revenue; attracting better lawyers; gaining access to new markets; becoming more efficient or famous for something important, maybe (but not necessarily) by becoming bigger or a part of something bigger. Successful law firm mergers therefore have a strategic goal of creating *value* by way of access to new or better clients, services, geographic markets, lawyers or talent that enhance revenues and profits. Since no one would want to merge with a firm less profitable and share profits, the resulting firm generally must hold the potential for increasing everyone's profits (and partner incomes) or it is not worth pursuing.

We think the best, easiest and quickest test of a proposed law firm merger is to evaluate the "Business Case" supporting the proposed merger — i.e., to develop the theory by which everyone will make more post-merger than they would as partners in independent firms.

The formula is:

Sources of new revenues
\+ economies of scale (cost savings)
– probable lost revenues
– increased costs

Following is a template that can be used to make this evaluation:

Sources of new revenues:
- Firm A services to Firm B clients
- Firm B services to Firm A clients
- Revenues from new clients attracted by the merger
- Revenues from potential new referral sources

Plus economies of scale — reduced costs due to:
- Elimination of redundant staff and facilities
- Consolidation of systems, processes and functions
- Bulk purchase savings; renegotiated vendor packages

Minus probable/possible lost revenues:
- Clients lost due to conflicts
- Lawyers lost due to merger
- Referral sources lost due to merger

Minus incremental costs:
- Transaction costs, including travel expense, value of lost time
- Integration costs, including consultants, management time, travel/communications

Prospectively quantifying the effects of the factors identified above requires some educated guessing, even speculation. It also requires a multiple-year approach, as transaction and integration costs in the first year or two of the merger often render any short-term benefit nil. Law firm economic forecasting models can be used to demonstrate potential long-term benefits.

The number resulting from this analysis will either provide justification for moving forward with merger discussions or for abandoning the merger altogether. Absent such analysis, it is difficult to reasonably assure members of both firms that, in fact, two plus two will equal five or more down the road. And there is no reason to consider a proposed merger unless that is likely. ◆

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