Succession vs. Independence: How Succession Challenges Could Accelerate Firm Combinations

By Joseph B. Altonji on March 28, 2023

Perhaps not surprisingly, two of the most frequent and challenging requests we currently receive are for assistance with "thinking through growth questions" (aka, "mergers and acquisitions") and "dealing with generational succession." What is less obvious is how often these two topics are intricately intertwined, particularly in mid-size or smaller law firms. We often find that the underlying motivations driving firms to attempt to grow through merger or, more often, acquisition, flow from a failure somewhat earlier to address critical issues around senior lawyer succession. Whether the firm would consider combining absent underlying succession issues is not always obvious.

Consider the succession-related challenges many smaller and mid-size firms face. Many of these firms are:

- Over-partnered (underleveraged)
- Under-led
- Not attracting/retaining enough talent
- Not transferring client relationships fast enough as seniors approach retirement
- Leaving the transfer of clients to the relationship partners without any oversight, process, or assistance
- Structured with their primary rainmaking capability concentrated in an aging cadre of senior lawyers, sometimes with a next generation of partners who were brought up primarily as service partners for the founders
- Lacking an obvious group who can step up and take the reigns
- Economically static – or potentially stagnant. Strong, growing mid-size firms are in an entirely different position

Making matters worse in some first-generation firms is an absence of a *structure* for transitioning clients. In these firms, a few founding partners still control 100% of the equity, with no mechanism (or impetus) to bring in new partners, or cost-effectively transition the founders out. In some – not all – cases, these founders also want to monetize their perceived investment in the firm, hoping to realize a significant goodwill payment from their departure. Making matters worse, many of these firms are also materially undercapitalized.

Not surprisingly, when some combination of the challenges listed above converge, it is increasingly common for the partners of the firm – whether equity or not – to wonder whether their firm can or should continue as an independent law firm or consider combining with another firm to bring in new talent, new leadership or potentially even a "buyout" (more on the viability of this outcome, below). They look to merger as a potential fix for what is inherently a structural or internal problem. While this may be a "Good Reason to Consider Combining…" (See: *We Want to Maintain our Independence and Other Strategic Irrelevancies: Thinking About Merger as a Small to Midsize Law Firm*"), most law firm combinations will not solve inherently internal challenges although they may help with some issues such as diversifying leadership talent. On the bright side, while they will not solve the structural problems, such combinations might provide a context and a pretext for finding a solution, although this may be more painful than many realize.

What won't a merger generally solve? First, simply combining your firm with another will not instantly re-leverage your practices. However, if you combine with a larger, more rigorously managed firm, solving this problem might be forced on you – usually as a relatively painful solution. Combination also will not instantly accelerate client transition, and those partners who have been reluctant or resistant to aggressively work on client transition are unlikely to get more interested in the project just because your firm is bigger and now has rules governing this process. Finally, if you are among those firms with a very closely held equity ownership, merging is unlikely to satisfy any "buyout" expectations those founding partners may have and will not result in an external infusion of capital. (In most situations, no one "buys" a law firm in the sense of writing a check to current owners to transfer ownership.) It *may* force you to address equity ownership for those current non-equity partners who should be part of equity, including creating an expectation that they provide an infusion of capital to the combined firm. Combining *may* make it easier to get some of the necessary things done to effectuate succession, but you still will have to do them, whether you combine or not.

While combinations may not solve the critical succession challenges we see at many firms, those challenges are likely, nevertheless, to accelerate a wave of combinations. The reasons for this include:

- Combining may help with some challenges associated with succession. For example, merging with a firm that has a stronger cadre of up-and-coming leaders will give you access to that deeper leadership pool. Similarly, if your combination partner has greater associate depth and a stronger talent acquisition and management program, you will gain access to those assets. If you have enough time, this could also provide additional options for client succession planning (though you still need to get the client-relationship partners to do it.) The combination also might bring with it a stronger "next generation" of rainmakers for those firms where the "next generation" are primarily service partners.
- Many firms with serious succession challenges are also at material strategic risk due to client concentration and skewed demographics. While the combination won't immediately change who is working with your clients, it will bring a diversification of client and key-partner risk.
- A combination with a stronger firm will inevitably force the issue on some of the other things firms need to do to assure their futures. It is often easier for firms to do the things they should do anyway – and maybe this alone is enough to justify taking the step.

Combination strategy and addressing succession, though, are two entirely distinct challenges, even if successfully achieving one might force you to deal with the other. For firms with serious succession management issues, we strongly urge you to face them directly. The obvious reason is that while there is no guarantee you can achieve a good combination, you still must deal with the succession issues. Simply considering combinations will take time, which almost always makes succession issues worse. Unlike fine wine, these problems get worse with age.

More importantly, successfully addressing serious succession challenges will certainly put your firm in a better position to achieve a good strategic combination outcome. The more baggage you bring to the table in a deal, the worse that deal is likely to look. In the extreme case, there are also some very good firms, who might be great combination partners strategically, who will be simply unwilling to take on the risk associated with your issues. Getting them solved before entering discussions will make you a stronger and more attractive partner and create a wider range of options.

It is certainly possible to address succession challenges while simultaneously pursuing combinations, and firms who do this with a strong leadership team will likely achieve strong results on both fronts. However, these two sets of challenges are not the same and you can't solve your succession issues *solely* by combining your firm with another. Worse, you may fail to do either if you look to a combination to solve your succession issues. There are *many* good reasons to consider combining, and we urge all firms to regularly evaluate their strategic positioning and whether a combination could be beneficial. If addressing succession is high on your list, we strongly urge you to develop a stand-alone succession management strategy, including addressing the difficult inter-generational equity issues that may exist, and work that strategy aggressively, whether or not you simultaneously pursue a combination strategy. This approach gives you the strongest chance of keeping your team together – whether as a strong independent firm, or as part of a great strategic combination.