"We Want to Maintain Our Independence" and Other Strategic Irrelevancies: Thinking About Merger as a Small to Midsize Law Firm

By Joseph B. Altonji on January 12, 2021

We appear poised to enter a period of more rapid consolidation in the legal profession, and as always the primary moderating factor will likely be the cautiousness or outright resistance of many smaller to midsize[1] firms to consider combining with any firm larger than themselves. The refrain of "we don't want to be acquired" rings loudly in Executive Committee meeting rooms. However, by its nature, this is an emotional reaction, not a strategic one, and we urge all law firm leadership teams to consider the strategic, client, cultural and economic factors, rather than emotional ones, in evaluating whether they should consider a combination. Obviously, those firms who decide to consider such combinations have a number of additional hurdles to cross to determine whether a particular firm is the *right* one to join, but those hurdles are the subject of numerous other articles (by us and others.) In this article, I will examine a range of good (valid) and bad (invalid) reasons to accept or reject the *concept* of combination with a larger firm. Let's start with the latter, but very common, considerations.

Some Bad Reasons to Avoid Combining…

"We Want to Maintain Our Independence."

This is perhaps the number one reason we hear for why many law firms reject even the idea of talking with a large(r) firm. But why? When we probe this response, it's relatively rare that the firm has thought the topic through in a thorough or structured manner. Instead, you will hear answers like, "we don't want people who we don't know and who aren't here telling us how to practice" or "deciding our compensation." But few acquiring firms of any quality would acquire a firm with the intention of "telling it what to do" and in all negotiations compensation, at least, will be on the table, so you should be in a position to understand and trust the process before closing. In any case, you will get to know your new colleagues during the process, so they shouldn't be people you "don't know".

So, what is really going on here? In most situations, this is either an expression of collective fear by the partners that something they like a lot (typically "culture") might somehow get upset by a deal – i.e., someone might actually demand accountability – *or* it's really the leadership or a segment of it that doesn't want to give up its seat at the head of the table. We frequently hear from the rank and file of such firms that they really don't care whether the firm is independent or not – although they would want to be sure that they are joining a firm that makes sense and where they will have a place.

Fear.

We're all afraid of something but, institutionally, law firms seem to be afraid of a lot of things. Fear of "losing our culture." Fear of accountability and concern over whether the partners can hold their own at a new firm. Fear that conflicts might damage the firm's ability to bring in new clients. Fear that clients might abandon the firm if they combine with a larger firm. Fear that their best people might leave. You can think of other institutional fears that might drive these discussions.

Some of these fears might be legitimate, although in some cases disingenuous. Rather than using fear to take a whole range of strategic options off the table, firms should confront such fears and consider their cause and their relevance to the topic. First, all of these and most other fears should be considered and investigated during the due diligence process. For example, while no two cultures are identical (and therefore *any* merger will have the effect of changing the culture of *both* firms) part of the merger evaluation is, or at least should, always be around whether the cultures of the two organizations fit well together. If they don't, you don't do the deal. We don't advise a firm to reject a whole class of strategic possibilities over any fear that can be objectively investigated and managed. Second, many fears tend to spring from an underlying sense of inadequacy. People who perform well should have no fear of accountability – and those who are afraid of accountability probably should be, and their current firm should do something about it!

"We Don't Want to Lose Our Identity."

While there is modest brand value in the names of many firms, in our experience such value is typically much less than is ascribed to it by the partners, and particularly those longer-term partners who have spent most or all of their careers building the firm. For most mid-size and smaller firms, the bulk of the actual brand/goodwill value tends to reside with the *individual lawyers*, and the clients are usually indifferent to the name on the door. (If they weren't, the lateral market would be far less active.) In any case, the industry has also developed multiple strategies around transitioning, capturing, and maintaining brand value through a combination. More often than not this topic is most strongly in play when either 1) some or all of the name partners are still active and have an understandable, yet personal desire to see their legacy continue in the form of the firm name or 2) many partners, especially those with a long history with the firm, see the firm name as an opportunity to scuttle a process they don't want to consider. The latter reason brings us back to the first two reasons noted above.

These "bad reasons" all share a common thread – they are based on emotion, rather than strategic consideration, or even fact. Firm leaders who are focused on assuring the long-term best interests of their clients and their colleagues will put aside emotional considerations and look hard at whether the firm's clients and lawyers would be better off if they were on a larger platform, and if so, focus their thinking on *which* potential combination would drive the most value for both parties.

Some Good Reasons to Consider Combining, or Not…

Would a Combination Advance the Firm's Strategic Goals?

Here we draw a distinction between the firm's strategic goals (or perhaps its strategy), and the firm's "Strategic Plan." While this might seem strange, we put it in the context of numerous strategic plans which, for example, simultaneously espouse herculean advances in the quality and depth of critical practices (e.g., build a national litigation practice, or a dominant second-tier PE practice) that require significant investment and the ability to attract resources (people) that are more likely attracted to national platforms, while simultaneously proclaiming their intent to "maintain their independence." While nothing is impossible, preemptively excluding tactics that are the most promising in terms of achieving the firm's real goals (What kind of a practice do we want to build?) is a strategic mistake. Most of the time, such strategic plan inconsistencies are intentional – trying to simultaneously placate both those partners whose practice goals are focused on changing the firm's market position and those partners who are most focused on keeping life as much as possible the same as it has been. Firms should clearly articulate their practice objectives and then determine the best way to achieve them, but this does raise the possibility that not all lawyers in the firm belong on the same platform.

Not all practices or all firms would benefit from a combination, and some would clearly be hurt. Firms focused on local

privately held businesses, for example, may have everything they need to properly serve their clients in most instances (yes, they may lose the exit sale) and might find combining with a larger firm too much of an economic strain on their client base. High-quality boutique litigation firms whose strategic focus is on building a commercial plaintiff's practice around insurance recovery or representing clients in disputes with money center banks are probably best served by building a high-quality base of talent on an independent platform. We can think of others, but firms whose practice aspirations would be advanced through a combination should not reject such tactics based on emotions.

Is Your Firm's Strategic Position at Risk?

As hard as it often is to admit, firms sometimes find themselves facing the erosion of their strategic position. This may be due to no fault of the firm – the legal market has changed dramatically over the past two decades, and the ability and inclination of clients to look beyond their home region for legal services is now fully established. Firms that once served the highest value legal needs for companies based in their region now find themselves handling only routine legal services and face continued erosion of their position. For a time, they may be able to maintain an illusion that they are still a key provider to these clients (particularly if their revenue continues to grow at least somewhat) but eventually it becomes evident that their position has changed. Even then the firm might not be forced to combine, but if a market becomes attractive to larger outside firms, the pressure on such firms will become extraordinary.

For firms in this position, or where it is reasonable to believe such a position might develop over a few years, the leadership would do well to consider a combination with a larger firm while the midsize firm is still in a good position.

Would Our Clients Benefit from a Combination?

If your clients benefit from a combination, your firm and your colleagues do as well. Clients benefit if a combination improves the value proposition associated with your services. This might mean that, through the combination, you can deliver higher-value services or you can reduce the clients' cost of obtaining legal services (including the ease/internal cost of managing legal needs). Can you now handle all or most of your key clients' needs rather than the 5% or so that was typically associated with your best client relationships? Do you now have the ability to bring a more diverse range of expertise to your clients' problems, which results in better solutions? Can you now properly scale to meet your clients' capacity needs? It is important to recognize that a higher value of service is not inconsistent with higher rates (which many fear will come with such a combination). While not all combinations require that the smaller firm increase its rates, clients will accept higher rates if the increase in the perceived value to be received exceeds the anticipated rate increases.

Would a Combination Create Opportunity and Increased Practice Quality for Our People?

Opportunity for the firm's current lawyers is always on the mind of top firm leaders, and the challenges come in many forms. Are you at risk of having your most valuable partners believing their opportunities are limited by a (relatively) smaller platform? If so, what is needed to address this? Another office or two, or a national reach? Are you facing hard-to-address succession issues that put the future at risk for your younger lawyers (and as a result the firm, as soon as the younger lawyers realize it?). Does your platform limit your ability to recruit the kind of talent you need to maintain and grow your best practices?

It is often the case that growth can materially increase the opportunities for some lawyers, or provide increased security for others, but this does not necessarily mean the right answer is to "be acquired." Maybe alternative growth approaches are more appropriate, and obviously, some lawyers and practices might not survive a transition to a much larger platform. However, assuring current and future opportunities for the firm's lawyers, including current stars and your future partners,

should always be a part of leadership's evaluation process. If a larger combination provides that for a majority of your people, it should be considered.

So, What Should Our Firm Do?

To be clear, we are *not* suggesting that all small and midsize firms should combine. *We, along with many consultants, have sometimes been accused of making such a statement to develop business and we want to be clear that we do not believe, and never have believed, in this or any other one-size-fits-all approach to law firm strategy.* There are good strategic reasons why some firms should remain independent, and many others have no need for a combination to assure their success. However, we do believe that many firms have rejected combinations on concept alone, for reasons which can only be described as strategically irrelevant emotional biases. If a firm's partners, fully understanding the strategic opportunities and risks, consciously choose to remain independent, that is an appropriate choice, even if comes with strategic constraints.

Our concern arises when the firm fails to really consider the good strategic reasons for combining (along with the downsides), typically avoiding such emotionally charged discussions in order to maintain a comfortable position that may or may not be in the best long-term interests of the firm. When leaders allow this to happen – or worse, foster it – they add to risk, rather than abate it. We encourage all firm leaders to embrace this debate on a strategic level, rather than take the shortcut of allowing emotional inclinations to sidetrack the discussion.

[1] We do not have a specific definition of "small to midsize" in mind here, but we regularly see firms across a range of sizes (say 10 – 400) who reject the concept of merging with a larger firm solely because they are unwilling to be the smaller partner in a deal.