# Why So Many Law Firm Merger Attempts Fail

By Michael D. Short on September 22, 2020

I recently wrote about the outcomes of our most recent 30 law firm merger & acquisition projects <link> within the context of a clear uptick in activity and our prediction of increased activity over the next few years. Within that article, I observed that:

- Statistically, based on our sample, 1 in 10 working concepts make it to a viable transaction.
- Then, one in two of our serious conversations (roughly) end up in a deal.

This article will explore why potential law firm mergers fail during each of these two stages of discussions and then review, specifically, why the 14 proposed transactions we were involved with did not result in a deal.

First, why do only 1 in 10 initial conversations create enough interest to advance to formal discussions (including NDA's and exchanging information?) Many law firm leaders tell us they want to grow via mergers (rather than by ones and twos) so why aren't we seeing many more press releases?

Here are some key reasons –

1. A declining number of viable candidates, generally – Given all of the consolidation in the legal marketplace, the number of truly viable targets is small and is getting smaller with each announced law firm merger. Some markets are more mature than others, making this worse in those markets.

2. Many good candidates are still want to, and can, go it alone – A fair number of really good potential targets, particularly for acquisition, don't need a deal and aren't interested in combining. Leaders of these firms will usually take a meeting with an interested party, if for no other reason than to keep their ear to the ground on what is happening, but they need to hear a new and compelling message immediately to get to a second conversation (which is the next point).

3. Lack of an exciting vision from the interested firm – Far too many messages in these initial meetings focus on the greatness of the larger firm, rather than on the benefits to the smaller firm. As a leader of the smaller firm that isn't looking for this deal, such a

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message sounds like "we are great; you're pretty good; you can be greater if you join us; it's obvious that you should do so…isn't it?" In our experiences, the initial meetings that are successful focus squarely on the benefits of the combination to the other firm with no discussion on comparative metrics.

4. Poor job done by many firms (and some outside advisors) on creating a realistic and focused target list in the first place – There's a huge difference between a list of law firms with something in common based on website searches and a true target list that applies knowledge of the firms and what they are looking for, as well as some critical thinking about why a particular transaction would be beneficial to both parties. A superficial list of law firms is a high-volume approach while a true target list is highly focused. As a firm seeking a partner, would you prefer to spend your time and money having many initial meetings hoping to find a point of connection, or in doing the research and advance work to narrow the field to a list of prospects where you have a real business case for potential synergy which can be delivered in those first meetings?

5. The two leaders just don't hit it off – Chemistry is very important at all levels of a merger discussion, but it is vital at the top. Some personalities just don't align. Both parties know it right away and the related conversations fade away quickly and properly.

6. "Cultures don't match" – This can be a conclusion based on a misalignment between important philosophies (e.g., partner compensation, bank borrowing, data transparency) or a sincere gut feeling that is not focused on any particular factor. Alternatively, it is often used if either party doesn't want to proceed for any reason that they don't want to explain in detail. Under this scenario, it is the dating equivalent of "it's not you…it's me".

If these are some of the primary reasons most first meetings don't go on to formal discussions, why do only 1 in 2 (or more, per the original article) that do move on to serious negotiations result in a formal combination?

After preliminary high-level analyses and a meeting or two, the parties usually sign a non-disclosure/confidentiality agreement and start to exchange information. During this initial due diligence phase, the following issues may arise:

7. The deal-killing conflict – One of the first items to be share, if not the first, is the key client lists (top 100 by revenue, for example). Each firm should create a conflict review team to study this initial list, plus additional "layers" as the deal progresses, to quickly find any conflicts which render the proposed combination a non-starter.

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This must be done early because a horrible outcome for a potential merger is a deal that gains excitement and momentum and then succumbs to a deal-killing conflict. Spare both parties from the related emotional let-down and get after this task immediately. (Note that sometimes this deal-killing issue ends the discussions with the first meeting, or even before it, if the party approaching a potential combination partner has a particular conflict issue that can be raised prior to an NDA because the representation is already public knowledge.)

8. Significant differences in Partner compensation, capital/debt, or other important philosophical underpinnings – A quick comparison of balance sheets will give a strong indication that one party may favor, as an example, the annual use of a line-of-credit and borrowing while the other party will never borrow under any circumstances. Another key area of difference that can be spotted early is the criteria used to allocate each firm's net income. Significant differences in philosophical/historical/cultural issues such as these must be identified and evaluated as soon as possible. If neither party is willing to move and no middle ground is possible, then the parties should probably shake hands (virtually) and part ways.

9. Two firms with the same bottom line operate dramatically differently – Once the financial information is exchanged, some law firm leaders will focus in on their firms' key/primary metric within the context of a merger. This is usually Profits per Equity Partner or Revenue per Lawyer. A narrow focus here could hide very important, and often irreconcilable, differences. For example, two firms can have similar Profits per Equity Partner results with one firm generating that result from a model in which there are few Associates and the Partners do most of the work at higher rates. Meanwhile, the other party may have a highly leveraged model in which much work is pushed down to many Associates and the relatively smaller Equity Partner pool is more focused on client relationship management and business development. Each model may work well for each firm, but a mix of these two models is difficult to manage.

10. "Cultures don't match" – See point 6, above. This one can show up at any time.

Once the preliminary analyses are done and the two parties are prepared to sit down at a (virtual) negotiating table to work on deal terms and try to create a combined firm, the discussions can still go awry in any number of ways, including:

11. Loose lips (sink deals) – While some partnerships are very open with respect to confidential discussions, others have the overall attitude that "there is no news unless there is news, in the form of a MOU, because most conversations don't end up in a deal".

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If a more transparent firm is the source of knowledge about a potential conversation to members of the other side or, far worse, to anyone else in the marketplace of the press, the leaders of the more closed firm will be put in a very difficult position with respect to their partnership. This scenario often destroys trust and ends the conversation.

12. One side is clearly trying to "win" – Some lawyers cannot help themselves and they let their M&A lawyer traits come forward into these discussions. Rather than trying to craft the very best outcome for each deal point, they take a hard line on each point and clearly try to create an advantageous position for their Firm from issue to issue. It's obvious when this occurs because most, if not all, points must be done the way one Firm already does it. Furthermore, all of the key leadership positions must be populated by people from this Firm. When this happens, it is disconcerting, distasteful, and discussion-ending.

13. One firm is clearly trying to solve a problem via the combination that they cannot or will not solve on their own – While this is not necessarily a deal-killer, the other party must realize the "ask" and be prepared to handle the issue head on. Examples include the inability to find the next firm leader, Client Relationship Partners, or business developers within the current partnership. We often see some combination of these characteristics in a first-generation firm where the initial builders of the Firm have held on too long and time has run out for them to address these issues. Another example of this are the firms who want to use a merger to get the other – typically larger – partner to do the hard work of dealing with productivity issues and poorly performing personnel (especially partners), rather than managing these challenges on their own. Some firms are strong enough to and capable of taking on situations of this type, but many will walk away from them.

14. One firm is experiencing downward performance trends while the negotiations are in process – During a period of COVID or uncertainty within either party (per point 13, as an example), relying on the prior year-end results as a basis for moving forward can mask a serious and steady decline in economic performance. This in turn usually stems from far more serious issues (e.g., lawyer or client departures, retiring Partners who are not leaving their books within the Firm, competitors out-strategizing the firm and taking its market share via a new and different business model). A month-to-month tracking of economic performance of both parties (to be fair) right up to the initialing of the MOU is needed.

15. Leaders ahead of the partnerships – When two leadership teams enter discussions it is assumed that they have the support of their partnerships, but this is not always the

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case. If either, or both, law firm leaders are relying on the deal and deal terms to concurrently get their partnerships to become receptive to the concept of a merger, the discussions will likely end when the unprepared partnership rejects the deal because they aren't ready to have the conversation. We see this regularly, but it's difficult to observe early in the process without speaking with Partners who are not involved in the discussions.

16. Inability to fairly balance the overall economic contributions from each party – When two law firms try to merge, it is important to evaluate the total economic value (per Equity Partner) that each firm brings to the potential combination. This is a balance sheet-based analysis that also includes all significant off-balance-sheet items (e.g., WIP, A/R, unfunded pension plans, leases, etc.) to get a full look at the relative contributions. Any significant variance needs to be addressed via a variety of solutions (e.g., capital account credits or contributions, keeping a certain amount of year 1 revenue for one side, one side keeping an in-process contingency matter) for the deal to move forward fairly and equitably. Some merger teams cannot agree to terms on this important point.

17. Inability to agree on a specific deal term – Yes, good potential deals do still end over issues such as the combined firm's name, who will be the practice group leaders, which Partner will be responsible for shared key client relationships (as opposed to asking the client who they want!), or which legacy firm's COO will be the COO of the combined firm. Emotions can run high once the discussions get into the weeds and, sometimes, the greater good is lost to these emotional responses.

18. "Cultures don't match" – See point 6 ( and 10), above. This one can show up at any time.

Of course, there are many additional potential deal-killers. This list is not intended to be all-inclusive.

So, as we look at our 30-transaction sample and the 14 that did not combine, why did those conversations end?

- 1 – Conflict, but not based on a specific client. Once we got into the details we found a serious incompatibility in the type of clients each firm represented in a particular practice area.

- 1 – Significant difference in philosophies around how to run the combined firm.

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- 3 – Cultures don't match, but in these cases, this wasn't an easy way to get out of the conversations. The parties just didn't feel comfortable going forward, and justifiably so.
- 1 – One side was clearly trying to win in the conversations and the other side took offense.
- 3 – A combination of a) A firm trying to solve an internal problem that the other party could not address, and b) One party trending downward significantly in the midst of the negotiations. In these cases, the problems were on the table and open, but the direct impacts to the firms' financial performances became too severe and distracting.
- 4 – Leaders were ahead of their partnerships. While the leaders had great visions and were trying to address specific strategic needs, it became clear in these transactions that "yes" votes from the partnerships at large were unlikely.
- 1 – Inability to agree on a specific deal term. This scenario is frustrating but when emotions kick in they are very difficult to control.

So, there are our 14 serious conversations that did not result in a deal. The reasons are diverse, which makes a close examination of these deals worthwhile. Each conversation is a unique event that can go awry at any time over myriad issues which is why, statistically, so few initial discussions result in a combination. Generalizations about merger work downplay this important fact. Remember that until the final votes are taken, and the merger agreements are signed, there is no deal and expectations must be managed carefully.

To repeat an important point from the first article –

> *The purpose of this piece is not to discourage. Rather, it is to manage expectations carefully. While law firm merger negotiations are basically on hold right now (and rightly so), these activities will return and accelerate once an appropriate level of certainty is established and we shift to level 3 of our Recovery Playbook <link>. While we need to wait on the formal negotiations, some of the deals that will be negotiated then are being explored right now. The business of law and the evaluation of strategic opportunities never stop.*

Good luck with your firm's strategic growth opportunities.

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