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The Urge to Merge

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In 2001, Hildebrandt International tracked 69 domestic law firm mergers, a slight decrease from the number during 2000. Merger activity slowed during the 4<sup>th</sup> quarter since many firms were focused on internal needs (productivity, collections, budgeting, etc.). However, results for the first quarter of 2002 reveal that the pace for mergers is quickening. Through the middle of March, nearly 20 mergers were completed. Expansion activities were simply placed in abeyance and firms realized that they needed to return to their strategic plans, including plans for expansion by way of merger.

Firms may feel compelled to merge as a way to enhance their presence in the marketplace, bolster their practice areas, and keep clients. In addition, firms faced with high salary pressures, increasing technology costs and the expense of following their clients into new markets, will evaluate the possibilities of merger. This article will explore some of the reasons to consider a merger and some of the resulting benefits.

### **Reasons and Benefits in Merging**

A decision to merge is driven by business reasons and should be considered as a means to accomplish strategic goals. Among the most common reasons for considering a merger are:

- To enhance market position/geographic expansion
- To fill in gaps in expertise and increase specialization.
- To gain the ability to attract clients that neither firm could attract on its own.

Although not considered a strategic reason for merging, some other benefits in merging include:

- To broaden the capital base.
- To correct internal weaknesses.

### **Enhance Market Position/Geographic Expansion**

A merger will allow the firm to gain access to new markets or increase visibility and strongholds in existing markets. This is particularly important as clients expand their business operations on a regional, national or global basis, rather than risk the aspect that its clients outgrow the firm's ability to service them. Geographic expansion can be more effective through merger, particularly since there is usually an existing client base on which to build. A benefit to this

approach it that cash flow is available from this base of clients, which helps to fund the start-up costs of the merger thereby reducing the need to borrow for working capital or other needs.

### **Increase Expertise and Specialization**

A firm may find gaps in its expertise or areas of specialization, resulting in an inability to serve clients' current or anticipated needs and clients demand a wide range of specialized services. Firms need to analyze their existing expertise and determine what other specialized resources are needed in order to service the ever changing needs of their clients.

Since most work comes from existing clients (through additional matters and referrals), it becomes important to constantly evaluate client trends and needs. For example, the firm may determine that clients will have environmental problems in the future and the firm will need this expertise in order to service the clients.

### **Expand Client Base/Attract New Clients**

Small and midsize firms experience a shrinking client base for a number of reasons, including clients being acquired by larger companies, business failures, and increased competition. For these firms, the answer to a shrinking client base might be merger. An ideal candidate might be a firm that needs additional expertise or depth to service an abundance of clients.

Some firms may find that they are too dependent on one client or practice area. A merger could broaden expertise, which may attract clients that neither firm would have attracted on its own. In addition, a top-flight litigation firm will look for a firm with a strong corporate practice in order to have a platform to gear up for future conquests.

### **Broaden the Capital Base**

Not necessarily a reason to merge but a strong benefit in merging is access to greater resources. Many firms find that making long-term investments can be cost-prohibitive—for example, adding lawyers, expanding offices or investing in new technology is very expensive. This can cause firms to become more and more leveraged and increasingly vulnerable to economic downturns. A larger firm may have greater resources to make such investments by spreading the dollars over a greater number of partners. Furthermore, aligning with another firm (particularly a larger firm) reduces the dependence on a small number of clients or a particular industry segment. It also reduces the risk of problems resulting from the loss of one or more partners.

### **Correct Internal Weaknesses**

For the most part, mergers are easier to accomplish for firms that have already corrected their internal weaknesses. However, mergers can be part of the strengthening process and resolve:

- Gaps in age and experience levels.

- Lack of rainmakers.
- Lack of leadership.

Firms can become too top heavy, which could lead to trouble if senior partners are unable to transition their practice or client management to the next generation. Law firms, which have been slow to encourage and teach business development skills, find that when rainmakers retire, there is often no one in the firm to replace them. Last, gaining effective leadership is difficult for many small and midsize firms; a merger can often provide needed leadership.

As can be seen, contemplating a merger without going through a strategic planning process is a recipe for trouble. It is not a goal in of itself but rather a mechanism for achieving a well thought out plan and identifying opportunities to capitalize on.