

# THE AMERICAN LAWYER

ALM.

americanlawyer.com

June 2, 2022

## Why Law Firm Mergers Are a Growing Reality For More Firms

Merger discussions among even some unlikely pairings seem to be heating up. In their new book, Kent Zimmermann and John E. Morris explain why and offer tips on how firms of various sizes and market positions should approach merger discussions.

**BY KENT ZIMMERMANN AND  
JOHN E. MORRIS**

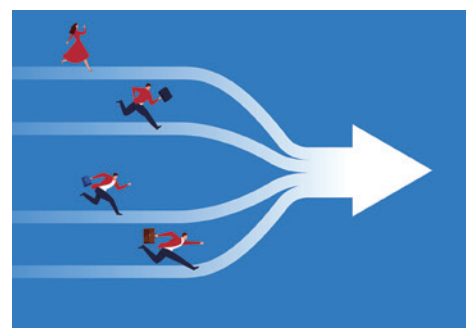
*Editor's Note: In their new book "Law Firm Mergers: Lessons From Successful Strategic Combinations," Kent Zimmermann and John E. Morris outline reasons for and paths to law firm mergers. In this first of three excerpts from the book, the authors explain why firms are increasingly considering a merger. This excerpt was edited for length.*

The need for growth is one factor driving mergers. Most firms want and expect to become a better version of themselves. Their partners aspire to maintain or improve profitability, quality and culture, and to grow. As clients increasingly value specialization and turn to firms that are known for excellence in given practices, sectors and geographies, firms must show 'bench strength' and quality as deep or deeper than peers if they expect to draw the most sophisticated, lucrative assignments. In addition, in a conventional pyramid firm structure, where partners are leveraged with associates and profit from

associates' billings, growth is essential to maintain or enhance profit margins and to create continuing opportunities for ascending young lawyers—that is, to make room for new partners without reducing leverage.

Scale also provides an advantage when it comes to pitching for business. Larger firms with higher-quality practices and sector teams can cite longer relevant deal lists, more lead deal lawyers who have mastered the industries on which they focus, more trial wins, more winning first-chair litigators and more relevant experience overall.

Not every firm needs to be a mega-firm, we should stress. Size, for these purposes, is relative to the market in which a firm operates. The relevant market might be geographic, a practice specialty, an industry or a combination of these. To sustain a leading corporate practice in a major financial center may require hundreds of lawyers and overseas offices, but a top transactional practice in a mid-sized city could be built on a much smaller



foundation. The key is a firm's size relative to its competitors—the firms with which it is likely to be compared by clients and the lawyers it hopes to recruit.

**Some firms are pulling away from the rest in size and momentum**

Scale is playing a part in an evolution of the legal services market. Over the past two decades, larger, well-managed firms have pulled away from the pack in the competition for talent and clients. Their momentum is like a flywheel, which sustains itself once it reaches a certain speed. The market share of top firms is growing at the same time they are attracting more lucrative work and paying their partners more. At the other end of the market, smaller firms that have outperformed their competitors

have generally done so by focusing tightly on a limited number of areas of strength and cementing their reputations in those areas.

For well-managed firms, scale can magnify strengths and those advantages can compound year after year, measured in both profits and market share. Market-competitive annual rate increases spread across more lawyers than competitors is part of what helps a firm separate from the pack. Once created, that momentum helps the firm pull away further from its historical competitors, often giving it an advantage in attracting and retaining the most talented, productive lawyers. As the practices and financial performance of leading firms become stronger, they also become more resilient—more able to weather regrettable departures and economic downturns, as well as maintain growth, even in highly competitive areas.

### **Compounded growth is a crucial factor**

Take two hypothetical firms that have been viewed as competitors, with practices of similar quality. One's profit per equity partner (PEP) is growing at a steady 5%, while the second, which is more focused and better managed, sees profits growing at 8%.

Starting at a common base, the PEP differential is small in the early years—just 5.6% after two years. Over the longer haul, however, as the higher-performing firm continues to grow off its higher base each year, the differential becomes very significant.

After five years, that firm would be ahead by 15% in profits. Even if its profit growth rate fell back to 5%, the spread between PEP at the two firms would continue to increase in absolute terms, because the second firm's PEP would be increasing by 5% off a higher base. This is not just hypothetical. For decades, talent has migrated gradually to the firms that lead their markets in compensation, and that process is speeding up. Increasingly, the market leaders in profits tend to be larger.

As the highest-performing firms in any given market attract more sought-after talent, they in turn draw more high-quality, high-rate business, which supports further growth in profits and more recruiting. The flywheel effect works in their favor.

### **Larger and more profitable firms have advantage in their peer group**

All things being equal, firms that are larger and more profitable than peers tend to have higher profiles and stronger brands, are invited to more beauty contests and attract more top talent. Nine of the 10 strongest law firm brands in the U.S., as measured by Thomson Reuters Acritas, were in the top 10 by gross revenue.

In addition, the costs of attracting and retaining high-performing lawyers, investing in technology and deepening geographic and practice capabilities are also easier to absorb when spread across a larger and more profitable partnership.

### **The prospect of a merger can force a firm to address problems**

There can also be other, less obvious payoffs to combinations. While they will not solve all problems, they often provide the impetus to address a firm's shortcomings. They may force a firm to move faster in counseling out chronically underperforming lawyers and they may encourage investment in growing areas of focus the merging firms share. Combining firms is also the occasion to look at the practices on each side of the merger, and to prioritize the growth of the best ones from each firm. This will enable the combined firm to become better known for excellence in its chosen areas of strength, gaining a reputation neither firm could likely achieve as rapidly on its own.

### **The risk of doing nothing also has to be weighed.**

The legal market is not static and firms that do not keep up with their larger and higher performing peers, whether through a merger or otherwise, are likely to fall behind in profits, market position and market share. They may find themselves with subscale practices that are not as well known and therefore not as widely recognized for excellence in the marketplace. That generally makes it harder to win business and to recruit and retain talent to improve their position.

*Editor's Note: This book, published by Globe Law and Business, published in late May 2022.*

## How a Smaller Firm Should Assess Whether to Seek a Merger

In an excerpt from their upcoming book, authors Kent Zimmermann and John E. Morris offer a checklist for smaller firms thinking about whether a merger is right for them.

**BY KENT ZIMMERMANN AND JOHN E. MORRIS**

*Editor's Note: In their upcoming book "Law Firm Mergers: Lessons From Successful Strategic Combinations," Kent Zimmermann and John E. Morris outline reasons for and paths to law firm mergers. In this second of three excerpts from the book, the authors offer tips for the smaller firm in a potential combination. The first part of the series can be read here.*

The larger forces of the legal marketplace pose threats to many firms that are either under-sized and/or less profitable relative to competitors.

### **How to begin evaluating the option**

Here are some questions to ask yourself if you practice

in a smaller firm and wonder about the merits of moving your practice to a larger organization:

- Do you or your partners feel that you are at risk of losing talent? Are you able to attract the laterals you most desire? If prospective hires declined your offers, where did they go?

- How much more business could you attract if you practiced within a firm with a higher profile in the market as well as more depth and breadth, including in your main areas of focus? Think specifically about what you might gain practicing within firms you admire and would consider combining with.

- Have you had to turn away projects that were too big or required specialists you do not have?



(Photo: Adobe Stock)

- Talk to clients. Would they send more business your way if you practiced on a platform with a longer roster of high-quality lawyers and more name recognition?

- Do you get enough opportunities to compete for the most desirable clients and lawyers, and is your success rate high enough when you do?

- What is the draw of being small? Does that outweigh the advantages of practicing on a more competitive and resilient platform with a high-performance culture?

- What do you most fear about combining with a larger organization:

- losing the firm’s identity;
- losing collegiality;
- having little input into management;
- having to change compensation; or
- being forced to raise rates?

Then ask: how could you mitigate those concerns if you combine with a larger institution? High-quality smaller firms whose rates are within range of larger firms are highly desirable and frequently have better options and more leverage than they realize when negotiating the terms of a combination.

Reflect on these concerns candidly. Are any of them undue? To what extent, if any, do they simply reflect a resistance to change or anxiety about uncertainties? Can those feelings be addressed?

**What to do if you want to go forward**

After reflecting on these issues, here are some practical moves to begin the process concretely.

The first steps are the same as they would be for any firm:

- Identify the firms that meet your criteria;
- Consult people who are deeply familiar with the market both in developing your criteria and identifying firms that meet them;
- Learn as much as you can about those firms based on publicly available data and private insights from people you know who are familiar with the firms;
- Research the key cultural attributes of your target firms; and
- Talk to laterals and others that know them.

If your firm is substantially smaller than your potential combination partner, it may be particularly valuable to talk to clients about what would benefit them most—types of firms, practices and specific firms.

Also, give thought to whether it is essential that all your lawyers are included in a combination, or whether you could accept de-equitizing some partners, or other changes that would strengthen your firm and

give it better options. Depending on the economics of your firm and those of the larger target, you may have to face those issues.

Consider, too, if the larger firm has higher billing rates, whether you would be able to move onto that scale in a reasonable period. Would your clients absorb the increases? Many smaller firms find that moving to higher rates on a larger platform is more easily achievable than they first thought. If you think higher rates would cost you business, would that be more than offset by new business you can attract working off the larger platform?

In later chapters, we will cover various protections a smaller firm may want to obtain if combining with a much larger organization.

*Editor’s Note: This book, published by Globe Law and Business, was published in May 2022. The third and final excerpt will offer lessons from firm leaders who have made the decision to merge.*



# THE AMERICAN LAWYER <sup>ALM.</sup>

americanlawyer.com

June 10, 2022

## Law Firm Leaders Explain Why They Sought Mergers

From market pressures to the need for confidentiality, law firm management explain why they sought mergers and how they got them done.

**BY KENT ZIMMERMANN AND  
JOHN E. MORRIS**

*Editor's Note: In their upcoming book "Law Firm Mergers: Lessons From Successful Strategic Combinations," Kent Zimmermann and John E. Morris talk to law firm leaders about what they learned as keys to successful combinations. In this third and final excerpt from the book, we note a few of the take-aways mentioned. Here are the first and second excerpts.*

### **Foley & Lardner**

In 2018, the 200-plus lawyer Gardere Wynne Sewell, a long-standing regional firm originally based in Dallas, merged into the 1,000-lawyer Foley & Lardner, whose roots were in Milwaukee.

**Holland 'Holly' O'Neil, former managing partner of Gardere:** We were at an inflection point for the firm. In 2013–2014,

coming out of the recession, Texas was becoming the preferred place for large companies to relocate. We were very fortunate in that regard. But, as large companies relocate, so do their service providers, and so there was an onslaught not only of businesses but of law firms coming into our market. Not only were they catering to these relocated companies, but they were going after what we had historically thought of as our mainstay, existing clients. That was the reality of being just a regional law firm when your long-time clients were becoming much more than regional in their business focus.

Most clients I talk to would much prefer a one-stop shop. The opportunity to be more of a go-to trusted advisor for those clients required us to look ourselves in the mirror and recognize that, just being a regional



Image: Shutterstock

law firm, we were getting lower and lower on the rung, as it were, compared to some of our competitors.

We had also been trying to aggressively lateral hire to try to achieve growth and were having really mixed results. At best, lateral hiring was offsetting normal attrition, but it really wasn't growing the business. In addition, we were in a talent race, not just about attracting new clients or laterals, it was also about keeping our up-and-coming folks, who were being assaulted by the allure of more money and more opportunities at national law firms coming into our markets.

In order to keep even what we had, it became really clear that we needed to try to do a combination.

**Jay Rothman, chair and CEO, Foley & Lardner:** There was the mirror image on the Foley side. For some time, we had identified Texas and Mexico City, and I had done some prospecting and spoken to firms in both Texas and Mexico City. We saw that as a hole in our footprint nationally. It's not just about geographic reach, but we also saw the booming corporate practice in Texas. We saw an oil and gas practice in Texas that we felt fit well with our renewable energy practice. We saw high-stakes litigation because there's a lot more litigation in Texas that is actually tried than in a number of our other jurisdictions. We had a substantial intellectual property practice and we were looking to expand that into Texas. Finally, we had a sizable health care practice, and we saw opportunity there.

### **HOGAN LOVELLS**

Despite protracted talks over a merger that would span three continents, management at Lovells and Hogan & Hartson

managed to keep a lid on their plans. That allowed firm leaders on both sides to present a comprehensive, compelling case for the deal to the full partnerships when the preparation was complete.

**J Warren Gorrell, Jr, former co-CEO of Hogan Lovells and chairman of Hogan & Hartson:** We kept this whole thing confidential for 15 months. I just can't overemphasize how valuable that was. We had a core team on each side that was practice-oriented, plus some financial, tax and ethics people—probably 25 people at the end, but at the beginning it was about 10. That team did all the analysis, structuring and negotiation of the combination. And the same was true on the Lovells side. The standard for sharing information internally in both firms was an absolute mission-critical, need-to know basis. Keeping the team down to only the people who had to know, and emphasizing to them that they had to be quiet—nothing probably helped us more in terms of ultimately getting this done than to have confidentiality throughout the project.

When it came time to tell the partners of each firm that a combination was something that we believe we should do and make an announcement to the market, we had really done all our homework. We were able to tell a convincing, complete story about why this made sense for our clients and our people. It was important to get that buy-in all at once, because once word gets out about something like this, every search firm, every law firm is coming after every one of your partners. Even your most secure partners get insecure when you talk about a merger, so there is a huge amount of fragility at that time.

Being able to keep this really tight for 15 months was so critical. Of course, it also helped sell it, because we had time to do all our homework and develop a structure and a business plan, so we had an answer to everything. Partners knew it had been studied and there was a firm-oriented rationale underlying it.

*Editor's Note: This book, published by Globe Law and Business, was published in May 2022.*