

THE MERGER MASTERCLASS

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Published: 06/07/2006

It is a fact that much consolidation has taken place in the legal marketplace over the past 20 years. Twenty years ago, it was common for small, strong niche firms to thrive alongside some of their larger counterparts. It was not considered strange for strong partners such as Julian Holy, Keir McGuinness or Stephen Finch to leave well-established firms and set up on their own. These new firms could realistically compete with — and indeed sometimes out-perform — their larger rivals.

Nowadays, it is the larger firms that hold the advantage. From the outset, the better-qualified graduates tend to be attracted to the larger firms where there is the perception that they will receive a better and more well-rounded training. The quality assistant solicitors and partners that wish to find new homes also tend to gravitate towards the larger firms. Allied with this concentration of quality fee earner resource, the larger firms can also offer their clients much more by way of legal specialisms, owing to their greater size.

While it may take a little time, the inevitable impact of this quality concentration is that the better clients will also migrate towards the larger firms, with the consequence being that the next 10 years are likely to see a further period of consolidation among law firms. The prospect of external finance being invested in the larger firms can only make this consolidation process more of a likelihood.

With the changing legal landscape in mind, most firms are now prepared to entertain a merger as a strategic possibility. Some firms will have as their target the aim to be a £10m turnover practice, others will target becoming a top 100 firm, a top 50 firm or to be part of the 'chasing pack'.

Whatever the strategic jump, merging, as opposed to a series of lateral hires, can often be the easiest (or less difficult) route, and the ways in which a firm can position itself to be a good merger target, whatever its size, remain roughly the same.

RULE OUT THE ALTERNATIVES

Some partners in 'smaller' firms genuinely feel that it is perfectly possible and straightforward to recruit good quality partners and assistants into their firms. Before McGuinness Finch merged with Osborne Clarke, and before Julian Holy and Kanter Jules each merged with Olswang, all three firms had made fairly concerted efforts to recruit and head-hunt. All three firms were relatively small, were very profitable with bluechip clients and they all had energetic and enthusiastic workplace cultures. And yet all three struggled in their attempts to recruit the quality of partners and fee earners that were required. There were plenty of candidates but none of the quality that was needed, and each firm could not afford to dilute the quality of the fee earner resource base that each had at the time.

Therefore, there were no 'what-if' scenarios when it came to these three firms merging. They had each explored the alternatives; in order to achieve the strategic aim of having a greater number of fee earners, each recognised the need to merge, and each firm was committed to the process.

ENSURE THE FINANCIALS FIT

While there are many figures that are important, the two headline ratios that really matter when it comes to judging whether there is a financial fit or not are fee income per fee earner and revenue per equity partner. Both parties to the merger talks should have similar ratios unless it is a potential national merger, in which case allowance must be made for regional differences in the two ratios.

The general rule of thumb is that the larger the firm, the greater both fee income per fee earner and revenue per equity partner will be. This fits with the premise that there is the migration of quality to the larger firms. In Legal Week's figures for 2004-05, fee income per fee earner for the magic circle was £328,000, while fee income per fee earner for the top 50 was down at £212,000.

The quality of both Julian Holy and Kanter Jules was evidenced by the fact that each firm's fee income per fee earner was close to £400,000, resulting in an easy fit with Olswang.

However, it is often the case that the smaller firm in a set of merger talks will have a lower figure than its larger counterpart, although a closer analysis of the smaller firm may reveal that if you were to strip away the unprofitable sections or the unprofitable clients, then the smaller firm's ratios would soon converge with those of the larger firm.

Difficult decisions may therefore have to be made, but a willingness to make them will inevitably lead to a greater chance of success when it comes to finding a merger partner.

Revenue per equity partner in the magic circle firms will be at or around £2.5m, while for firms at the lower end of the top 100, it is likely to be closer to the £1m mark. Smaller firms will generally be more highly geared than larger firms in terms of equity partners.

Four of the six equity partners at McGuinness Finch agreed not to enter equity at Osborne Clarke, while a natural process of retirements at both Julian Holy and Kanter Jules meant that Olswang's revenue per equity partner of circa £1.5m will have actually improved as a result of the two mergers.

STRONG PARTNERS SHOULD LEAD FROM THE FRONT

If a partnership has proactively made a strategic decision to enter merger talks, then these talks need to be effectively led by one of the strongest equity partners — not necessarily the firm's managing partner — who in turn needs to be fully supported by other equally strong partners.

Clearly demonstrating a commitment to each stage in the merger process is crucial. There will undoubtedly be sticking points in merger talks along with the normal anxieties surrounding change, and a strong, influential partner will be able to lead from the front and distinguish whether such a sticking point can be overcome or whether it constitutes a deal-breaker.

Colin Kearney from McGuinness Finch, Simon Kanter from Kanter Jules and Julian Holy were all at the sharp end of the merger talks and each was the partner with the highest profile in their respective firms.

COMMUNICATION WITH CLIENTS

A firm's key clients must support the strategy of merging — quite often it is the firm's clients which prompt such a strategy in the first place. A key client, for example, may feel slightly exposed if all its legal work is being carried out by a smaller firm.

One benefit of communication with a key client that is trusted is that it may well give you a feel for the type of firm that it likes and, additionally, it may give you an indication that there is the potential for more work to be won in a firm that is well resourced in all disciplines, or in a firm that services other jurisdictions.

BE FLEXIBLE

The reality is that for most firms, the ideal merger partner does not exist. There will generally be issues that will grate, and so it is important to be flexible and yet at the same time it is also important to know when to stand your ground.

And so, the process of consolidation does look as though it is set to continue. This will happen whether law firms like it or not, because ultimately it will be driven by clients which themselves are subject to the laws of globalisation.

I have met some tremendous characters over the past 10 years, some of whom have made their mark in smaller firms. I only hope that these larger firms of the future retain the capacity to encourage and to nurture such characters, without which, the law would be the poorer.

Please note that Ian Moulard was formerly head of the mergers team at EJ Mergers.