ANDREW HEDLEY, DIRECTOR, HEDLEY CONSULTING

Dealing with deal breakers in merger discussions

In any merger discussion, there will be a limited number of areas which have the potential to be deal breakers. These range from issues of strategic significance to those of timing. In the first category are questions which challenge the longer-term logic of a deal which has few tactical obstacles. The second is concerned with significant tactical challenges which appear insurmountable despite a strong strategic rationale.

While issues such as IT infrastructure, operational systems, processes and line management need to be worked through and agreed, they rarely constitute challenges to overall viability. Deal breaker issues go deeper and strike at the core of strategy, culture and economics.

At the outset, parties must see a strong strategic fit and significant unrealised potential into which the new firm could tap. This may emanate from the joint client base, practice area synergies or improvements to the cost base. Taken together, they create a source of sustainable competitive advantage and drive profitability.

At the same time, however, legal or commercial conflicts between significant clients of each firm could scupper any negotiations at first base.

An early-stage assessment should be made of culture fit between partners across both organisations. What are their personal drivers, ambitions and ethos? In the absence of workable common ground, negotiations will most likely founder or a vote be undeliverable. Cultural convergence must be the longer-term aim if the firm is to be more than two tribes occupying the same office space or letterhead.

Negotiation bear traps

Governance, profit-sharing arrangements and capital requirements are all areas in which firms may substantially differ. The merging of balance sheets in ways which are seen to be equitable by both sides, coupled with the valuation of intangibles such goodwill, all provide potential bear traps for the negotiators.

Significant differences in profitability, profits per partner and balance sheet strength cannot be ignored. These are nettles which need to grasped at an early stage. Such discussions are emotionally charged and difficult, but it is crucial to have clarity as to the shape of the new firm, the number of partners and projections as to profits.

Property issues are widely recognised for their potential to derail negotiations which otherwise have a strong strategic and operational fit. Given the impact that property costs have on the profitability of any law firm, this is unavoidable.

> **“Cultural convergence must be the longer-term aim if the firm is to be more than two tribes occupying the same office space or letterhead”**

Alternative resourcing models and the rise of flexible working means that firms are now looking at their property requirements in different ways. A merger could provide an opportunity for a clean break or could lock the new business into a series of long-term liabilities.

Professional indemnity insurance can also be a stumbling block on the merger path at both a practical and emotional level. Claims histories generally tell a story about quality and management, as well as carrying real longer-term premium implications. Live claims and potentially notifiable events need careful consideration when analysing the financial and reputational risks inherent in any transaction.

Law firms are people businesses and getting the human resource model right will separate a successful firm from one which is divided along lines of geography, working practice or legal discipline.

Such considerations go beyond numbers of people and the way in which they are distributed; they strike at the heart of how the new firm will deliver service and value in ways that its antecedents could not. In many cases, a fundamental divergence of opinion on these core operational principles will mark the end of discussions.

Finally there are, of course, a whole range of issues that may seem peripheral but which collectively have the potential to be of high impact. These may include, for example, annuities to former partners, long-term immovable liabilities, and skeletons of all types lurking in cupboards which carry operational, reputational and financial risks.

A common point of heated debate is the subject of ‘promises made’ to junior partners or associates which are difficult to accommodate within the new structure. These need to be identified and resolved for the deal to progress; each has the potential to play a part in derailing the process.

At this level, no single issue may be critical but, when taken together, the number of things which ‘don’t feel quite right’ can sow pernicious seeds of doubt.

Early response strategy

In any negotiation, the small number of high-impact deal breaker issues need to be identified, debated and agreed at an early stage. Simply ignoring such matters, or side-lining them for discussion at some future point, is not an appropriate strategy. Such an approach runs the risk of negotiations being ended at a much later stage when such deal breakers can no longer be ignored, with both firms having made significant investments (both financial and emotional) in the process which are now abortive. mp

Andrew Hedley has been advising law firm leaders on strategy and change management for over 15 years (www.hedleyconsulting.com)