BEFORE THE MERGER –
COMPATIBILITY ASSESSMENT

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My last article (*Before the Merger—Due Diligence*), focused on some of the most important aspects of pre-merger due diligence. In its most basic terms, merger due diligence is about enabling both firms to really know what they're getting or becoming part of. It's about avoiding misperceptions and misconceptions, bait and switch tactics, or creating problems for a firm where there were none before. This article examines the next pre-merger phase, that of the compatibility assessment. The purpose of this phase is to ensure that in one or more years post-merger, the majority of partners of each formerly separate firm are still sitting around the conference table together.

It's possible that you or your firm, or a colleague's firm, have had the experience of successfully completing a merger, only to find it slowly disintegrate over time. So although the merger never officially "fails", one by one the partners or practice groups of one of the merged-in firms defect, until some time down the road there is little if anything remaining of the merger. It happens all to often. But why?

In most cases, there was a failure to thoroughly examine essential compatibility issues before the merger. In fact, many firms do a decent job of due diligence, but quickly gloss over all but the most concerning areas of potential incompatibility. There are a very large number of capability issues to explore between firms. They run the gamut: firm culture, business management styles, marketing sensibilities, compensation, quality and credentials of lawyers, and so forth. Let's take a look at some of the issues, and why they're so important to explore *before* the merger takes place.

1. What are the **COLLECTION HABITS** of each firm? Does one firm follow-up regularly on receivables and keep the cash flowing while the other allows their receivables to become stale and uncollectible? Does one firm routinely monitor and "put the pen down" on clients who have not paid, whereas the other continues to allow the client to get further and further into debt? Does one firm

take account receivable write-offs or seriously past-due balances into account when computing future partner compensation, thereby creating accountability, when the other does not?

Incompatibility in this area can lead to disputes regarding compensation, and strong resentments about perceived poor quality of clients and careless business practices. Partners quickly come to resent financing the poor intake and management habits of others. Don't assume that one firm's better procedures will "rub off" on the other firm's attorneys post-merger. Without accountability, old habits will persist, and feuds will eventually erupt.

2. Are the **BILLING RATES AND WORK HABITS** of the two firms compatible? If there is a large disparity it can spell trouble. It doesn't matter if one firm agrees to "allow" the other firm to keep its rates lower. Eventually it will lead to resentments and conflict, because profitability will not be as good for those with lower rates, unless they consistently work more hours.

   Sometimes partner egos get in the way of reasonableness when it comes to rates. I've encountered more than my fair share who believe that no one of comparable years can have a rate higher than their own. Rather than being happy about sharing in the increased profitability some are able to garner, they will fight to keep the rates of others lower or level with their own. I know, it makes no sense to me either, and that's precisely why you need to explore these issues. At least if you're going to have a constant bickering about setting rates, you should know that going in.

   By the same token, work habits become critical to compare. Is your firm a "quality of life" firm? (And please don't answer yes because it sounds good, if in fact your firm requires 2000 or more billable hours/year from associates!) Is your firm a "highly aggressive" firm? If one firm's attorneys typically work nights and weekends, and the other firm has empty hallways on weekends and dark offices at 5:00 o'clock on weekdays, there will be resentments and conflicts in short order. Now of course there are management ways to work around these issues. For example, introducing pay incentives for those who (continue to) work greater hours can eliminate the resentments and conflicts, and even motivate lesser producers into working more. The important part of the process, however, is to uncover this information going in, so you can address whether either firm is willing to change or accommodate.

3. Are the **BILLING HABITS AND REALIZATION RATES** of the two firms similar? If one firm routinely fails to bill timely, and/or consistently discounts its time value upon billing, whereas the other firm has a much better billing realization and billing habits, it will spell trouble downstream. These habits directly relate to cash in the bank, and distributable profits to partners. Bad habits which adversely affect cash, and therefore compensation, quickly lead to open conflict.

4. Are both firms similar in the **LAWYER CREDENTIALS** they seek when recruiting? What are the criteria each firm uses in hiring attorneys? Some firms feel they must have absolute top credentials. Ivy league education. Top 5% of the graduating class. Prestigious awards. Law clerk for a respected judge. And they are not only willing to pay the price to attract these lawyers, but actually feel they *must* do so in order to maintain their "pecking order" in the legal community. Another firm may feel that they are not in a position to recruit these types of candidates, or may more realistically conclude that they are not in a position to attract them like the "name brand" firms in their area. So instead they will focus on solid candidates who seem to have a "fire in the belly" to succeed. Their sensibilities will focus on product over credential.

   Don't underestimate the importance of something as seemingly simple as credentials in making or breaking the long-term success of a merger. Those at one end of the continuum will feel that others at the firm don't care about the quality of the firm, and are willing to let it go downhill. Those at the other end of the continuum will feel that others at the firm, if left unchecked, will allow their hubris to literally bankrupt the firm. When it comes down to it, they will not tolerate what they perceive as nothing more than arrogance to affect the dollars in their pocket.

   Related closely to this issue is a difference in philosophy between lateral acquisitions and "home grown" attorneys. Bringing in lateral hires aggressively can cause dissatisfaction and turnover in the associate ranks. But at some firms the desire to avoid mentoring drives the acquisition process just as or more strongly as the desire to achieve sustained growth, or fill gaps in the attorney ranks. Other firms find this aggressive lateral hiring offensive to their sensibilities of how lawyers should be treated and nurtured, and how the firm should grow from within.

Listed above are but a few examples of the types of issues which should be carefully examined and openly discussed with potential merger partners. Space limitations preclude me from delving into additional areas. Hopefully, this article, like the last, has raised your awareness that the process may be more involved than you thought.

There are a wealth of good articles available to assist you in this process. If you need guidance in finding them, please contact me. You may also want to obtain and review *Anatomy of a Law Firm Merger: How to Make—Or Break—the Deal*, by Hildebrandt International. It is available at the ABA section discount rate from PBA, and you can order it by calling member services at 800-932-0311.

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