

Growth Strategies for Small and Medium Sized Law Firms

By Tony Williams, Jomati Consultants LLP

Introduction

This article considers the way in which small and medium sized law firms can achieve growth. It also examines the reasons for such firms to grow and the issues to consider before embarking on a growth strategy.

Why Grow?

It is often automatically assumed that all small and medium sized firms should seek to grow. But growth is not necessarily the right option for every law firm. Growth may be promoted by the following factors:

Clients - Some clients may be reluctant to use smaller firms or to give smaller firms a significant amount of their legal work. They may be concerned as to the firm's lack of breadth or depth in areas of interest to them. For example a firm advising on property work may not have the necessary resources to deal with the tax issues arising from property acquisitions or disposals, may not have the capability to deal with disputes relating to property including disagreements with tenants, neighbouring owners, contractors etc, may not have the experience to deal with planning or construction issues or may lack the necessary skills to deal with innovative financing arrangements. Developing these capabilities, which are adjacent to the firm's core property expertise, may enable the firm to develop a more comprehensive service to its clients and as a result capture a higher percentage of the client's legal spend.

Managing the Business Cycle - A firm may wish to develop practice areas that are less cyclical than the firm's main business. For example, a corporate or property practice may perform very well in a bull market but be much more subdued in a bear market. In such a case, developing a non-cyclical or counter cyclical business may provide a level of protection whatever

happens in relation to the business climate. Such practices could include litigation, insolvency and restructuring or regulatory work. Each of these tends to be non-cyclical or counter cyclical businesses.

Competitors - It is important to be realistic as to who the firm's current competitors are, what they offer that the firm does not and how compelling their offering is compared to that of the firm. There will probably always be larger firms in the market. So, the issue is not just the size of the firm. It is appropriate for the firm to ask itself the following questions:

- a. What clients do we want to work for?
- b. What work do we want to do for them?
- c. How compelling to clients is our proposition compared to the proposition of our competitors

and, finally, how SMALL can we be and still provide credible answers to the first three questions?

Succession - Smaller firms are potentially more exposed to the incapacity or retirement of any one partner. That partner may have control of many of the firm's key client relationships. As a result, an orderly succession plan may be key to the sustainability of the firm. This may necessitate the development or recruitment of further partners able to take over an older partner's clients and/or to develop additional clients of the firm. A broader and more diverse client base will reduce the firm's dependence on any one client and provide a portfolio of clients that are likely to be active throughout the business cycle.

Operations - Operating a law firm requires a level of infrastructure. This includes premises, IT systems, cybersecurity

protection, compliance with Law Society rules, conflict checking, money laundering compliance, human resources management, accounting systems (including client accounts), professional indemnity insurance, lawyer training etc. These issues can consume a considerable amount of the partners' time. A large firm may be able to allocate these costs over a greater number of fee earners and recruit specialists in accounting, IT, HR etc to reduce the day to day involvement of the partners in such matters thereby releasing their time for greater client involvement and fee earning.

Before embarking on a growth strategy, a firm needs to analyse and understand why it feels the need to grow. It may be appropriate to have open discussions with a range of the firm's clients to understand their concerns or otherwise and to consider whether a growth strategy will address their concerns.

Why Not Grow?

Growth is not without its challenges. Accordingly, before looking to grow a firm one should consider:

Loss of Control - As a firm gets larger and adds more partners, the existing partners may have less control over the operations and future direction of the firm. Especially for founding partners, this may be personally quite challenging as they have devoted considerable time and energy to establishing and building the firm. It is their baby. They may be reluctant to let other partners take the firm in a different direction.

Risk - The growth strategy may not immediately achieve the growth of revenue and profits anticipated. Accordingly, the firm may have higher overheads but little or no increased revenue or profitability. This may place

pressure on the firm's working capital requirements and falling profitability may cause some lawyers and partners to consider if they wish to stay with the firm.

Bureaucracy and Cost - A larger firm needs somewhat more formalised structures to deal with office administration and may necessitate the recruitment of senior support staff to undertake a range of administrative and management issues. This may add an additional layer of process and bureaucracy to an otherwise nimble (if partner intensive) structure. Some partners may rail against such processes and procedures. It is also possible that the fixed costs of operating the firm will increase although, hopefully, it should enable the cost per lawyer of such expenditure to reduce.

How to Grow

Once having carefully weighed up the benefits of growth against its potential negative impacts, if a firm still wants to grow it has three main options to consider:

- a. Organic growth
- b. Enhanced organic growth by lateral and team hires
- c. Merger

Organic Growth - The first and easiest growth option is to look carefully at what the firm currently does and how the business can be expanded. This may be by doing more of its existing work for current and new clients or by developing adjacent or new areas of work where the firm feels that there are opportunities to stretch and develop the work of the firm. Having identified the growth opportunities, the firm needs to consider how its existing resources could be deployed to exploit these opportunities. Does it have partners or lawyers with the appropriate skills or appetite to develop new clients or areas? Should some senior lawyers be promoted to partner to develop specific opportunities? Should the way in which the firm describes itself on its website and marketing materials be revised to stress the new focus of the firm? Can it achieve ranking in the legal directories for the new

areas?

The organic approach is likely to be the least disruptive method of growth, but it is also likely to be slower and have less immediate impact. The lawyers charged with the new development will need to demonstrate energy and focus to achieve this change. If they merely focus on their existing "day job" it is unlikely that any discernible change will be achieved in the short to medium term. For lawyers (including partners) asked to develop new opportunities it may be appropriate to agree clear action steps to be taken and results expected to be achieved. It may also be appropriate for the firm to make clear that by doing what the firm wishes their remuneration and status in the firm will be protected at least during the initial execution stage.

Enhanced Organic Growth - If organic growth is unlikely to achieve sufficiently rapid results, a firm may consider enhanced organic growth by seeking to hire lateral partners or teams of partners. This is not without challenges. Experience has shown that many lateral hires fail to deliver their initial potential. There may be many reasons for this. They may be subject to restrictive covenants that impede their ability to move clients to their new firm. Although they have worked for clients, they may not control the client relationship so the client may remain at their old firm. The client may choose not to follow the partner but to choose another firm. The partner may not have the value of client work or depth of client relationships claimed. The chemistry between the new partner and

the existing partners may not work.

To be successful firms need to be rigorous. They need to be explicit as to the type of person they want and the skills he or she should have. They need to understand how much they are prepared to invest in the new initiative not only in terms of initial recruitment but in terms of ongoing support as the new business develops (it is relatively usual for it to take three years for a lateral to achieve his or her full potential). The existing partners need to be clear as to the effort they will make to enable the new partner to succeed whether by introducing existing clients, making associates available or jointly pitching to potential clients.

Potential laterals that the partners know are likely to be more successful. Partners should be encouraged to mention partners that they know or who they have worked opposite and who could be a good fit. If recruiters are used, they should be properly briefed and managed carefully. Extensive due diligence will need to be undertaken, if possible, involving discussion with the lateral's former firms or contacts. Once identified and recruited an extensive "on boarding" process will need to be undertaken to ensure that the lateral or team feels welcome and integrates well into the firm.

Some laterals and teams will work well and over time, deliver the expected growth of the firm. Inevitably, some will fail. In such cases the firm may need to act robustly to address the failure and to avoid further damage to the culture, morale and sustainability of the firm.



Merger - If organic and enhanced organic growth cannot achieve the required growth a firm may consider a merger with another law firm. This can be seen as a way, in one move, to achieve the firm's growth ambitions. But a merger is not a silver bullet. It can raise a series of difficult issues and any merger opportunities need to be considered rigorously before committing considerable time to them. Our Jomati report "To Merge or Not to Merge – That is the Question" looked at many of the issues that arise during merger discussions and how the merger process should be conducted.

In reality a firm needs to be very clear as to why it is considering a merger and what it wishes to achieve as a result of a merger. This needs to be done in advance of any merger discussions. Clarity as to what you are looking for enables the firm to avoid wasting time on abortive discussions with unsuitable firms.

Before embarking on merger discussions, a firm should ensure that its own house is in order. Any issues it has need to be addressed. This is analogous to selling a house or car. A car that is clean and in good working order will always be more attractive than a broken down, smelly heap!

It is also important to be clear what the combined firm is trying to achieve. What will the combined firm be able to do that both the constituent firms do not currently do? What will be its message to current and potential clients and how compelling will that be? What impact will the merger have on the career aspirations of the lawyers in either firm? What impact will the merger have on professional support roles?

Mergers are expensive in terms of partner time and professional support (consultants, property advisers, tax specialists, accountants etc) and the initial costs of integration, including possible premises moves, can be significant. The firm will need to prepare financial budgets and cash flow forecasts for at least the first two years post-merger to ensure that it is affordable. These projections are best prepared on a best

case, mid case and worst case basis.

Detailed due diligence will need to be undertaken to ensure that both parties really understand the other firm and that potential issues are identified, understood and addressed as soon as possible. However, the legal and financial due diligence is the comparatively easy part. The real challenge, and where most mergers fail, is on cultural issues. What is the other firm really like? How do the partners behave? How are lawyers and support staff treated? How well are clients served? What is the glue that holds the partners together? How involved are the partners in the management and strategic direction of the firm? How really committed are the partners to the merger and to making it work? These can be difficult issues to identify and usually necessitate multiple contacts between partners in each firm. The feedback from these interactions needs to be carefully recorded and analysed.

The vast majority of law firm merger discussions do not result in a merger. This is not a bad thing. Being prepared to walk away from a potential merger that does not meet your initial requirements or where there are significant cultural issues is a sign of leadership. There is no guarantee that a suitable merger candidate will be found. However, it is also necessary to be realistic. A merger partner that meets 100 percent of your requirements may not exist but one that achieves 60 percent or 70 percent may still be a credible choice. The issue then is to be clear how the combined firm will together obtain the missing requirements and whether it is likely to be able to do so within an acceptable time period and at an affordable cost.

Clarity as to the future strategic direction and management structure of the combined firm is essential. The more exciting the opportunities for the combined firm the more likely it is that issues that arise in due diligence can be satisfactorily addressed.

It is important that law firm mergers are not conducted the same way as an M&A transaction or litigation settlement discussion. You do not need or want a

winner or loser in the negotiations. If the negotiations succeed all partners will be partners in the combined firm for many years to come. Winning every last point in the negotiations may sour the relationship and either result in the combination not happening or, worse still, a group of partners feeling disaffected and demotivated and potentially leaving shortly after the merger.

Conclusions

As I hope this article has made clear, there are good reasons for a small or medium sized firm to consider a strategy for growth. But growth can have certain disadvantages and it is important that a firm understands and seeks to mitigate these before it develops a growth strategy.

A growth strategy needs to be clear. There is usually little benefit in growing unless it will make the firm more robust, more sustainable and in due course more profitable. An initial step is to understand the opportunities for growth within the existing firm and to seek to maximise growth based on its current head count and resources. This may involve identifying areas that the firm wishes to exit or de-emphasise and those where it can develop further either by adding new clients or new areas of work.

Lateral hires of individuals and teams can accelerate a firm's growth but do need to be approached with a degree of caution. A clear rationale for the recruitment, timeline for delivery and the support to be provided by others in the firm must be established.

Mergers are often seen as a panacea. They are not. A successful merger takes time and rigour. They will be time consuming not only in the initial negotiations and integration stage but for some time thereafter if the expected synergies are to be realised.

Growth can have many benefits for law firms of all sizes. Even the global legal giants of today were small or medium sized law firms only one or two generations ago. But be very clear what you are trying to achieve and then execute with focus and drive. ■