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Small Law Firms Become Big Merger Targets

The law firm merger market is heating up, and small law firms are right in the middle of it. The legal consultants at Altman Weil, Inc., who carefully track law firm mergers, now report that there were 27 law firm mergers and acquisitions in the U.S. in the third quarter of 2018, bringing the total number for the year to 79. Both of those numbers represent all-time highs for law firm mergers in the U.S.

The record pace is not necessarily surprising. From 2007 to 2012, there was an average of 53 mergers in the U.S.; since then, the merger market has been considerably hotter, with an average of 89 combinations. Last year, the number exceeded 100 for the first time. The torrid merger rate this year, then, is merely a continuation of a trend that has been in place for five years. But as Altman Weil Principal Eric Seeger has said, the factor that is pushing mergers into record-breaking territory this year is a "shift in attitude" at midsize firms that are looking to grow through acquisition, and the smaller firms they are targeting.

They don't always get the attention they deserve. We hear a lot about mergers involving megafirms, and not without reason. It's well worth noting, for instance, that some of the largest mergers to take place this year have involved behemoths looking outside the U.S. for growth. Dentons, Littler and DLA Piper all made cross-border acquisitions in 2018. But that obscures the fact that in this hot merger market, small firms are involved in the overwhelming majority of the combinations. Twenty-two of the 27 firms acquired in the third quarter of 2018, for instance, had between two and 20 lawyers. On the year, 62 of the 79 mergers have involved such firms. Similarly, last year, 80 percent of all mergers involved a firm with fewer than 20 lawyers. And many of these small firms—about half in the third quarter—are being acquired not by The Am Law 100® firms, but by law firms with fewer than 50 lawyers.

What's behind all these marriages between small and midsize firms? Seeger says it is driven by both "threat and opportunity." Sometimes, those factors are two sides of the same coin.

For small firms, joining with a larger merger partner can relieve some intense pressures. For small law firms that have a lease renewal coming up or need to take on a new line of credit, merging with a midsize firm can relieve much of the pressure that comes with making long-term financial commitments. The small firms most likely to be attracted to a merger for those reasons are probably those that have aging leadership and have failed to put a succession plan in place.

Where those firms see a merger as relief from a threat, others see it as a chance to grab opportunity. A merger with a midsize firm, for instance, can give a small firm access to the investment it needs to attract larger clients. As the midsize Pennsylvania firm Cipriani & Werner explained to Law.com®, for instance, satisfying banking clients requires a heavy investment in cybersecurity and other technology. A merger with a midsize firm, therefore, can make it more realistic for the attorneys at a small firm to serve banking clients—or to serve their existing clients better. Likewise, small firms may soon wish that they could expand their service offerings for their satisfied clients. A union with a midsize firm can allow small firms to offer their important clients something closer to full service.

For their part, midsize firms may also be motivated by threat and opportunity. Barry Genkin of Blank Rome, who regularly works on law firm mergers, notes that it can be perilous for a midsize firm to stop growing. If clients read that as "treading water or stagnating," he says, it can be difficult to retain them, and to attract talented lawyers.

Avoiding a perception of stagnation may not be the best motivation for a firm to look for a merger partner. In other cases, however, small firms can unlock opportunity for midsize firms. Merging with a small firm is an attractive way for midsize firms to enter a new geographic market or a complementary practice area, or to increase market share in a thriving practice area. The just-announced merger between Manning Gross + Massenburg and Kurowski Shultz ticks a few of those boxes. Manning Gross is a trial boutique with a number of offices around the country. It does not, however, have an office in the St. Louis area, a plaintiff-friendly jurisdiction that holds strategic importance—making Kurowski Shultz the perfect addition.

Small firms should be keeping their eye out for such chances to grow their practices, as long as the merger market remains red hot.

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