July 1981

Mergers:

Issues to be Considered in Retrenchment Settings

Working Paper #9
Retrenchment Papers

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FORWARD

The following papers have been developed under a grant from the Office of Field Services of the Legal Services Corporation.

They represent the views of their authors only and in no way should be construed as OFS policy. Their aim is to help programs think through the many difficult issues presented by the current threats to Legal Services and to develop effective plans. The papers are based on many interviews and work with local programs as well as derived from the wider literature on retrenchment planning. Given the press of time, we have chosen to make them available in initial drafts. We would appreciate criticism and alternative formulations on these issues and if appropriate will include feedback in subsequent papers or revised drafts. Please send any comments to

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Merger is a common strategy employed by orgranizations in cut-back situations. Simply stated, a merger is the joining of two or more organizations to form a single new one. Unfortunately, most of the research on this topic has been coducted in the private sector. Public concerns have been ignored. However, there are a number of generic issues that can be "carried over" from one area to the other. Any legal services program should consider these thoroughly before deciding on office consolidation. These general topics are outlined in the remainder of the paper. Each is supplemented with examples of how it might materialize in particular program settings. It should be stated at this point, that this is not a paper on how to merge legal service offices and programs. It is simply an effort to stipulate some of the key issues that management should be aware of when a move is made to combine offices.

Mergers usually come about because someone in a position of authority feels that by combining organizations a corporate entity that is somehow more viable than the existing ones can be created. In other words, this move can increase chances for survival and growth, improve staff performance, etc. The process consists of a pooling as well as a paring down of resources, i.e., manpower, buildings, equipment, etc., with the intention of obtaining the following results:

a) reduced operating expenses, such as lower overhead and less salaries payable;

b) reduced competition for external resources, e.g., two programs would no longer be fighting for funding from the same foundation;

c) increased efficiency, under the assumption that consolidation will eliminate slack; unused space, under-utilized employees;

d) increased effectiveness; the combination of a through c listed above will result in a new organization more capable of carrying out its mission. So, a merger of legal services offices is aimed at either 1) continued service delivery to the poor (as opposed to extinction), or, in some cases, 2) a marked improvement in that delivery.

Consider the following example. (Note: All examples are derived from actual program histories. Details have been altered to mask the their identities.) A large urban program is currently targeting offices for consolidation. a through d listed above play underly most of the major parts of their merger plan.

a) Reduced operating expenses. Four offices will be reduced to two. Moves will be made from buildings rented by the program to buildings that the program currently owns. Office equipment, typewriters, desks, etc., will be pooled. Any surplus will be sold off. This consolidation of facilities and equipment is estimated to result in a reduction in operating expenses of 20%. However, this 20% will not be sufficient to counter-balance their anticipated reduction in funding. A portion of their personnel will have to be let go. In the new offices there will be a redundancy in some job types, e.g., there will be too many receptionists. These positions can be eliminated at considerable savings without seriously harming the performance of the organization. With the reduction in salaries added to the reduction in other expenses brought about by merger, the program estimates that it will be able to sustain overall budget cuts of up to 40%.

b) Reduced competition for external resources. As the LSC retrenchment becomes a reality, programs begin to seek alternative funding sources. Efforts include everything from grass-roots efforts to raise seed money for larger fund-raising drives to application to large benevolent organizations, e.g., the Ford Foundation and the United Way. Whatever the scope of the operation, it is always easier to concentrate the effort around one office instead of two. In this case, two offices will be competing for funds instead of four.

c) Increased efficiency. The management of this program has reasoned that it will be able to use the merger as a way to reorganize some of its resources so that the new offices will operate more efficiently than the old ones. The most striking example is in the area of personnel. The present ratio of attorney to support staff (secretaries, receptionists, and clerks) is 1:0.9. There are clearly too many support people. The dysfunctional dynamics of this overstaffing is acknowledged throughout the program. There have always been too many people in these job categories and not enough work for them to do. Jealousy and infighting among the staff is commonplace and productivity has shown a steady decline. With consolidation and lay-offs the management believes it can bring the legal-support ratio to 1/2 or even 1/3 and thereby cut out slack time and increase productivity.

Another example taken from this program, illustrates how equipment can be upgraded during a period of reorganization. A number of offices machines, e.g., mag card typewriters, which the staff have "forgotten" how to use will be sold. The money obtained from their sale will be used to buy a word processor as well as train both legal and support staff to use it. This will dramatically decrease the amount of time it takes to type and correct documents.

These two illustrations demonstrate how mergers can be used as opportunities for reorganization on both the human and equipment levels. Subsequently, the new organization will perform in a way that utilizes its resources to the maximum.

d) Increased effectiveness. The program reasons that merger is the only way it can survive the impending budget cuts. In addition, a number of smaller programs are considering joining with it as a survival strategy. Management at this point is looking at ways that it can in some way tap in to the resources of the progressive sector of the private bar. These "demi-mergers" would allow them to continue litigation that they would have to eliminate under a reduced budget. Foremost, then, merger would allow them to continue service delivery.

In this particular case, consolidation will also provide them with a means of improving it. They will be able to close down an office which is no longer in an area populated by poor people. It is a section of town that is being reclaimed and renovated by the upper middle class. By moving the staff currently housed in that location to an area with a higher concentration of the poor they will be able to provide service to more of those who need it.

These elements a - d are not confined to mergers within programs. They also appear in consolidations on the program level. And appear when an LSC funded legal aid group is considering joining with a non-LSC sponsored one. The following illustration shows how the pattern emerges in an "external" merger situation.

A small urban program is considering a merger with another legal aid group in their city. They feel that by joining they could successfully form a "united front" with their competitor, while reducing a number of their expenses. As things stand, this other group has a number of funding and political advantages. It receives Title XX funds. Both the United Way and the local bar perceive them as more conservative As a result, they are more sympathetic and supportive to them than they are to the LSC program. The people within the rival program are committed to the same "mission" at the LSC group, and are considering the merger. However, in light of the current LSC financial picture, they are wary of joining with a disintegrating enterprise. In the words of the LSC program director, "The don't want to hitch themselves to the Titanic." So while merger would through a consolidation of both internal and external resources improve efficiency and effectiveness, long range political viability is dependent upon being able to maintain high enough funding levels to keep the new organization going. This hints at one of the drawbacks of this strategy that will be examined more fully in the next section of this discussion.

Management must keep in mind that while merger can improve overall organizational performance on a reduced budget and is therefore an important strategy to consider in austere times, it is also important to seriously consider its negative aspects. Experience shows that consolidation, even under the most favorable circumstances must be approached with caution. Unexpected and often dysfunctional consquences usually result to some degree. The remainder of this paper presents an overview of the general problems associated with consolidation strategies.

1. Unpredictability.

Although consolidation often seems like a logical, straightforward strategy -- implementation always results in unforeseen consequences. A plan that looks clean on paper can turn into chaos in the actual program setting. Anyone who has lived through or studied the process will agree that you never know what is going to happen until the move begins. What can be said with any certainty is that some of the consequences always have a negative effect on the new organization.

Appended to this paper is an article which recently appeared in Fortune magazine. It reports on the disasterous results of what was originally inteded to be an advantageous merger of two very successful private sector firms. After the two joined, there was a loss of staff, clients, and overall organizational viability. This example is useful in the LSC context because it demonstrates how consolidation can create the reverse of what management intends.

2. Structural Incompatibility.

The different groups coming together in a consolidation attempt may be organized very differently. For example, a small one-attorney rural office might merge with a large urban one. Odds are that the office staff from each will have entirely different daily routines, e.g., different intake methods, deal with different sets of problems, and use office equipment that will either be redundant or incompatible in the new setting.

Merger can also change personnel structure so that it will either compliment or detract form overall organizational performance. Our example of the program that is planning to alter staffing ratios demonstrates how structure can be improved. Without sufficient planning of this sort, a "top heavy" or "bottom heavy" organization can result. It is not difficult to imagine an office with two many support staff and not enough legal staff to supply them with work, or too many attorneys and not enough support staff.

If merger results in similar structural problems, a set of unanticipated costs will most likely accompany them. Lay-offs, retraining, selling and aquiring equipment, etc. all contain hidden costs, e.g., lost staff time, that can undermine merger as a viable strategy. Expensive moves become more costly during austere times. The new organization should be charted carefully, inventories taken, personnel assesses, etc., <u>before</u> the consolidation takes place. A heightened awareness of what the structural problems ~~might be~~ as well as a plan for coping with them, is critical to the success of this strategy.

3. Functional Incompatibility.

The offices slated for consolidation might share the same mission or goal. In this case, it might be stated that all LSC programs exist to deliver quality legal services to the poor. But the specific service that each office delivers and the means by which they do it might be entirely different. Going back to our example of a large urban office merging with a small rural one, the populations served might have different sets of problems. The former might carry out its intake by client walk-in, the latter through a telephone system or circuit riding. The urban program might deal with minority issues that require a bilingual staff. The rural one might treat a homogenous all-white population. One might focus on litigation, the other on service work. This list could go on and on. But at this point it should be clear that service delivery and mix can differ dramatically from office to office. Reconciling these differences should be a primary focus in planning a merger.

As with structural problems, functional ones are most effectively treated beforehand. Reviews of the types of cases, clients, delivery modes, etc., should be carried out and compared to see where incompatibilities are likely to arise. Again, it must be stressed that this is no guarantee that the new organization will function perfectly. It may, however, reduce a number of costs and strains as well as provice management with an opportunity to redesign the service mix and delivery system.

4. Internal Impact

Merger not only impacts upon the organization as a whole, but also upon the individuals who make up that organizatio In situations where consolidation occurs for "survival" reasons, it can communicate a message of decline and impending collapse. This often leads to a "rats deserting the sinking ship" climate. Functional and structural incompatibilities, as well as any lay-offs that result, can exacerbate the uncertainty and resulting stress. This will tend to further reduce productivity and accelerate the exit rate.

Some simple examples from actual cases follow. The intention of presenting them is to make this abstract notion more concrete by telling the story of real individuals in actual retrenchment settings.

- Two attorneys specializing in housing law are moved to the same office. In their old offices they were the only specialists in that area. This unique position gave them special status. They were considered the authority on housing cases. In the new office situation turf issues immediately begin to spring up. Each is constantly trying to "prove himself" to the other as well as to the other members of the organization. Eventually, the pressure becomes to great for one of them and he exits.
- A secretary has worked in an urban office in her community for many years. She is a single parent. In this work situation she has been able to walk to work and drop her child off at a nearby day-care center on the way. A merger resituates her in another part of town. She no longer feels a strong community tie with the clients she is serving, she must rely on a poor mass transit system to get to and from work, and she has to find alternative care arrangements for her child. The merger becomes very "expensive" for her; she leaves.
- A number of rural one attorney offices are merged with an urban one. The clients are now served largely by telephone. Some of the attorneys feel they will be more effective if they stay out in the country. Fortunately, there is a high demand for private lawyers in this area. Instead of moving to the city they go into private practice.
- A paralegal who has moved up through the ranks from clerk,

to secretary, to her current position and thoroughly knows her office and clients is retained in a merger. However, because of union procedures she has been bumped down to a secretarial position. She does not feel that the lowering in status is justified after her years of loyalty. Bitter and hurt, she leaves.

These examples, while certainly in no way covering the complete range of individual scenarios, illustrate how mergers can seriously affect the lives of those involved. Before consolidation open discussions between management and employees should take place if the program politics allow it. The needs and options of each person should be evaluated and incorporated, if possible, into the larger consolidation plan if they are to be retained. If not, serious efforts at constructive outplacement should be made.

4. External Impact.

Mergers also communicate a number of messages to influential individuals and groups outside the organization. This is especially true in the case of an organization that is as politically volatile as LSC. Clients can feel deserted, and political friends can sense uncertainty and withdraw their support.

One program with a long history of mergers, is still feeling the repercussions of a consolidation that took place ten years ago. The merger closed down an office in a an area where both the clients and the local politicians were particulary active. Instead, of reacting in a supportive way and aiding the program in this time of financial crisis, considerable anger surfaced and attempts to undermine service delivery in other areas the program served were initiated. These continue to this day.

Furthermore, a "new" organization has an identity quite different from the old ones than it was "created" from. It is usually treated by outsiders with the same suspicion and concern as any other "unproven" enterprise.

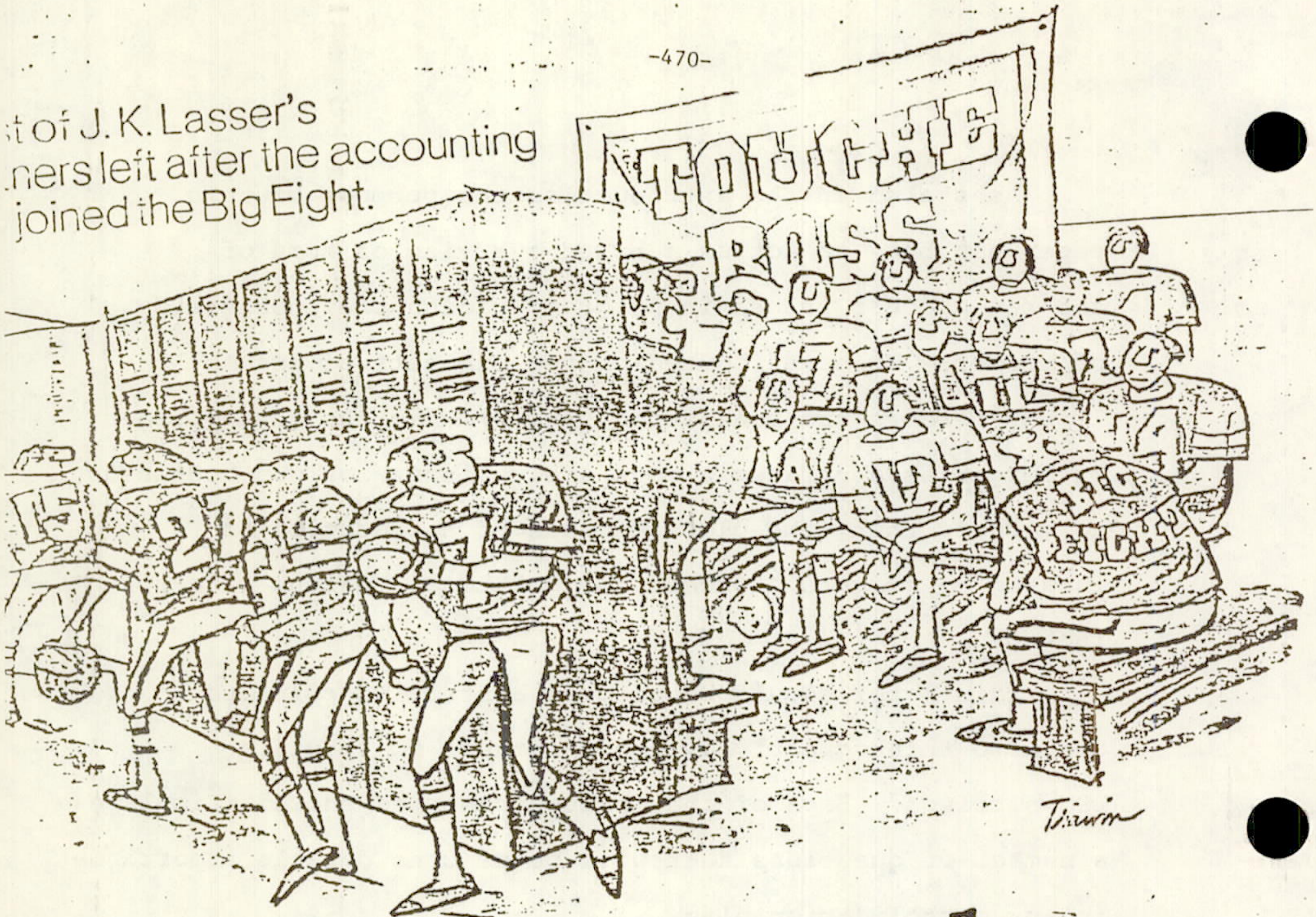
In another case, a merger resulted in closing down two rural offices and openning a new one in a location that was equidistant from the old ones. The reasoning behind this was that the new office could serve both sets of clients and would minimally incovenience the staff. However, the clients served by the previously existing offices were angered and refused to travel to the new location. An entirely new set of clients emerged. These were people who lived near the new office. The staff had to face all the start-up problems common to openning a new office, e.g., setting up files, public relations, etc. All of this was added to the other strains and costs associated with mergers.

It is advisable to scan the political environment before the merger takes place. If resistance or conflict is anticipated countermeasures by the program can be formulated.

End Note

As stated in the introduction the purpose of this paper has been to act as a brief overview of some of the key process issues in programs facing the possibility of merger. We have focused on two sub-sets of issues, 1) why mergers are considered, and 2) what the consequences of merger as a strategic move are. Discussion was confined to mergers that take place because of a reduction in funding -- mergers "forced" for political reasons were not included.

This paper should be used as a starting point to begin to think creatively about mergers in specific LSC settings. Each of the issues presented should stimulate a number of questions that will be of considerable importance in any consolidation plan.



...t of J.K. Lasser's
...ners left after the accounting
joined the Big Eight.

Why Lasser Found Touche Ross Taxing

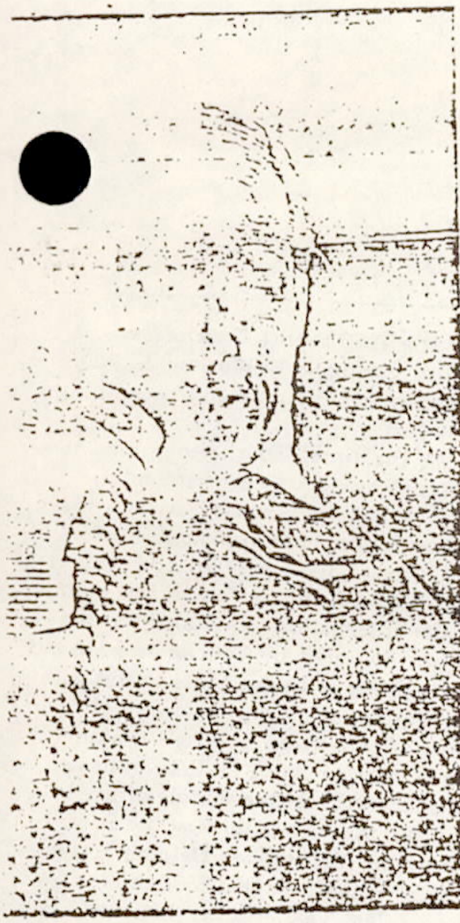
by STANLEY H. BROWN

The partners of J.K. Lasser and Touche Ross have been learning firsthand that it takes more to bring off a successful merger than consolidating the books. The combination of the two accounting firms in 1977 has created a liability—bad will among the Lasser partners—and exposed Touche Ross's weakness at handling human beings, assets more important in accounting than any that appear on the balance sheet. These problems also show that Touche Ross and the rest of accounting's Big Eight—all of which have thousands of partners around the world—are becoming as complicated to manage as the biggest client corporations they audit and counsel.

The marriage of Lasser and Touche was a quickie, arranged during one of those periods when Congress and the regulators were getting restive about all big mergers. Touche ranked eighth among the Big Eight and Lasser stood in the middle of what they call the Second Seven. The merger was the biggest ever in the profession. (Afterward, the merged firm retained the name of Touche Ross & Co. and the Lasser name simply disappeared.)

The reason for the rush, recalls one partner, was "to scramble the eggs thoroughly so the feds couldn't unscramble them later." But thrusting the two firms together denied the partners time to plan for the inevitable problems of internal politics and psychology. Even though "the feds" never intervened—and later allowed an even bigger merger between Ernst & Ernst and S.D. Leidesdorf—some eggs got unscrambled anyway. Fifteen of Lasser's 145 partners chose to go out on their o... retire rather than go along with th...

Research Associate Lisa Miller Mesdag



Touche Ross's managing partner, Russell E. Palmer, 46, insists he made a dandy merger, although plenty of former Lasser partners see it differently. Palmer, who didn't like being at the bottom of the Big Eight, hoped the merger would elevate Touche. Maybe it did and maybe it didn't. The way accountants keep their books, it's impossible to know for sure.

e... of the 130 who joined Touche as p..., only 44 remain, and some of them are also looking to leave.

Before the defections came disillusionment. The prospect of joining the Big Eight was so intoxicating to many Lasser people that they shrugged off whatever misgivings they had about the fit of the two firms. "At school, everyone aspires to be a Big Eight partner," says one Lasser man who has left. Another recalls approving the merger without hesitation because of "the excitement of becoming a Big Eight partner."

Lasser had more practical reasons to merge. One ex-Lasser man at Touche recently speculated, "We would eventually have gone bankrupt without the merger." That may be overstating it, but Lasser did have some serious financial problems. During the 1960s, it had grown through a string of small mergers from an East Coast firm into a national organization top-heavy with older partners. Lasser had a pension plan that wasn't funded: pensions were paid each year from current income. The younger partners who would h... to foot the bill were eager for a ... that would help lighten the load. M...ver, Lasser was finding the costs of liability insurance and specialty training hard to cover.

For Touche's managing partner, Russell E. Palmer, 46, Lasser looked like the way to climb out of the Big Eight's cellar. At 6 foot 3, the blue-eyed, blond executive from Jackson, Michigan, looks like the grown-up version of the boy next door, and he has always aspired to be more widely known. They say that when Palmer joined Touche's Detroit office back in 1956, fresh out of Michigan State University, he decided there was no point in staying unless he could make managing partner. He made it nine years ago and became, at 37, the youngest person ever to head a Big Eight firm.

"Seven other armies"

Since then some have noticed that strutting beneath his friendly, fresh-scrubbed countenance is a determined street fighter. Palmer once stopped payment on a departing partner's last check when he learned he was joining a competitor—and also threatened to sue the competitor. One former partner says Palmer thinks of his competitors this way: "There are seven other armies out there, and we're going to kill them."

But since big accounting clients don't move around all that much, and have been diminishing in number with mergers, Palmer figured a few years ago that the only way to move up from eighth place was through a big acquisition. He set up a committee to prepare a "hit list" of merger prospects, and in 1976 Touche made a pass at another of the Second Seven, Laventhol & Horwath. Its partners balked at the terms.

So it came down to Lasser, which had a lot to offer, whatever the state of its finances. For one thing, it had revenues of around $45 million. Touche at the time was grossing $185 million in the U.S., and Palmer thought Lasser's total would push Touche well up in the Big Eight rankings. Lasser was founded by the late J. K. Lasser, whose name still adorns the perennial best-seller *Your Income Tax*. (The firm has no other connection with the book.) Not surprisingly, the firm had a substantial tax practice. Among its 25,000 clients in 1977 were more than 90 public companies, of which only two—Kane-Miller and General Cinema Group—were big enough to make the FORTUNE 500. Lasser also had several clients in book and magazine publishing, where Touche had none. What's more, as more than one competitor has noted, since Lasser's partners and clients were largely Jewish, the merger would give Touche special access to the Jewish business community.

Some Lasser partners expressed concern about the disparities in the two firms' clientele. Lasser's clients were mostly small private businesses, while Touche's list was dominated by the likes of Sears, Prudential Insurance, and Chrysler. But Touche argued that Lasser shouldn't worry about compatibility: Touche had lots of small clients too. In fact, all of the Big Eight have been trying to cultivate smaller private companies lately. Small outfits need and buy more outside tax and management services than big companies, so they can be highly profitable.

These services have come to constitute a significant share of Big Eight business. At the same time, auditing has become less profitable. In the wake of the foreign-payments scandals, many large corporations have beefed up their internal controls, which means less work for the outside auditors. So it made sense for Touche to acquire a firm whose partners were comfortable working with the smaller companies.

But the reality was something else. As one Lasser man says, "When I sensed the 'corporateness' of Touche in contrast to Lasser's close partnership environment, I knew it wasn't for me." Others sensed that Lasser's kind of business was viewed as somehow second class by Touche people in Atlanta, Minneapolis, and Jacksonville. All the Lasser partners in those cities left without even bothering to move into Touche's offices. Elsewhere the disaffection was more gradual, but it has been relentless. There are no Lasser partners left in Los Angeles, only one each in Chi

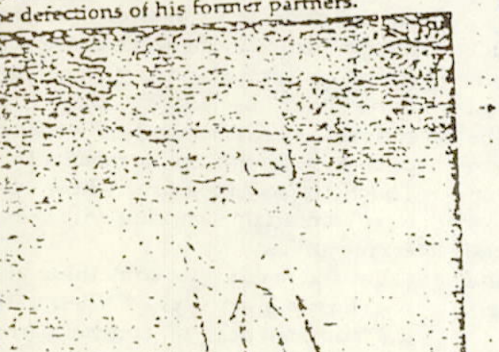
continued

cago and Boston, three in Houston, and so on. For the most part, they were allowed to go and even to take clients with them. At least for a while.

Then Palmer decided to get tough with the defectors. That meant invoking the "noncompetitive" agreement that makes it difficult or impossible for departing partners to resume accounting practice without forfeiting their share of retained earnings or vested pension benefits. Even in states such as Michigan, where the courts rarely enforce the agreements, at least one departing Lasser partner has filed suit in an effort to get his money. Touche sometimes settles these cases, but not quickly.

At least a couple of the angry Lasser people concede that their feelings are aimed partly at themselves for, as one

The last managing partner of J.K. Lasser, Herbert P. Sillman, 53, insists his firm needed the merger with Touche Ross. Now a member of the Touche board, Sillman blames top management's insensitivity, his own included, for the defections of his former partners.



said, "conning ourselves into thinking it was anything more than a hard-nosed business deal." Nevertheless, the rancor is so great that one seemingly sensible ex-partner has literally taped a picture of Palmer to the seat of his desk chair. Some of the wounded Lasser people are reacting perhaps to the awful suspicion that they were taken. One man who was a Touche partner at the time of the negotiations implied as much recently: "When the Lasser thing came to be, I said that within three years there would be very few Lasser people left. It was a game designed to get a client base."

In one sense, Palmer may have got pretty much what he wanted. Touche kept all of Lasser's big public clients, as well as its publishing business, and got most of the Lasser tax staff. Palmer says Touche kept at least 75% of Lasser's business, but that doesn't seem likely considering the way defectors took clients with them and the way other clients were inexplicably all but pushed out the door.

For instance, a memo from a top Touche partner to all Houston partners included a list of some 150 Lasser clients there that, he said, "we feel could be better served by other accountants." Among them was Rice Food Markets, the biggest independent food chain in town, with billings of around $100,000 a year, a big client by any firm's standards. Rice finally got fed up with Touche's cavalier treatment and pulled out in 1979.

Fourth, fifth, sixth—or eighth

Whether Palmer succeeded in moving up among the Big Eight is an open question. He says Touche is now "fourth or fifth or sixth" in worldwide revenues. But he can't prove it. That's because one of the great ironies of the accounting business is that, while all the big firms put out some figures each year, only one—Arthur Andersen—offers audited statements.

Touche issued an unaudited annual report for 1978 that revealed its foreign and domestic revenues and earnings. In 1979 it again told all, except for domestic revenues. But when the time came for the 1980 report, Touche issued a bro- chure giving only worldwide volume- no domestic volume and no earnings any sort.

At the time, Touche explained it w discontinuing its "experiment" in fina cial reporting because "certain financ information isn't comparable from fi to firm." This seems an odd reason b cause the one figure Touche saw fit to pu lish—international volume—is the o most disputed by Touche as well as t rest of the industry. More to the point is the one that sheds some light, ho ever clouded, on Touche's ranking. A that number, $611 million, indicates t Touche isn't in the middle of the pack all but still down there at the bottom hind seventh-ranked Deloitte Haskins Sells, which reported $690 million wo wide last year. Palmer believes his ures, but not his competitors'. As a Tou spokesman explains it, "We're ca they're not."

Palmer says blandly that among th Lasser partners who left, he would l liked to have kept ten. Then he sh the matter off with: "I'll lose ten good p ners out of Touche this year," leaving implication that it's just a casualty of mal turnover. Pressed to comment on heavy drain of people after the me Palmer blames it on "a certain mind among a few of the Touche partne charge of the offices with large Lasse fections. If he had it to do over, he "I think I'd get my Mr. Compassi Broad Gauge Flexible Person and st him out there."

The man who handled the merg Lasser, managing partner Herbert I man, is guarded in his comments. senior Touche partner and member board, he is based in Detroit, from he ran Lasser. "We just weren't enough. We weren't sensitive eno the emotional problems," he says ring to the defections. "It had not do with our ability to do the work to do with our inability to people well enough." Welcom ities of big business.