

# The Consolidation of the Global Advertising Industry: Lessons for Law Firms?

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Law Firm Evolution: Brave New World or Business as Usual?

Georgetown

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# Common questions about outside ownership of law firms

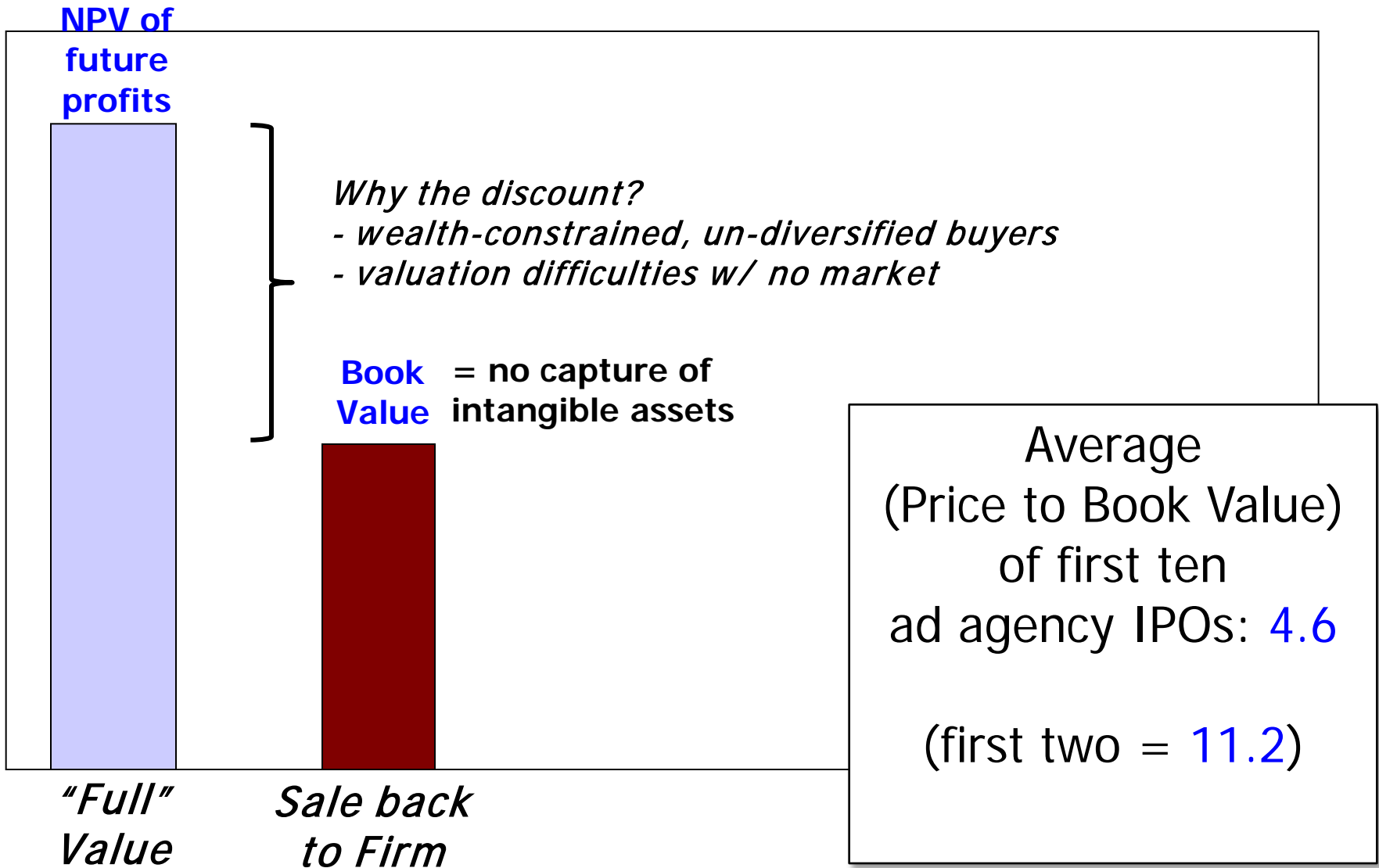
- Why would law firms need external capital?
- Why would investors invest in law firms, if the assets can walk away any time?
- Won't it hurt the firm's competitiveness?
- Which types of law firms are likely to go public?
- What effect might it have on the industry

=> Some conjectures based on research into other professional services: advertising, as well as i-banking and consulting

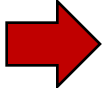
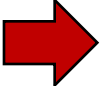
# Why would law firms want external capital?

- Investment
  - expand scale and scope through acquisitions
  - fund risky lawsuits
- Liquidity & diversification – i.e., cash out

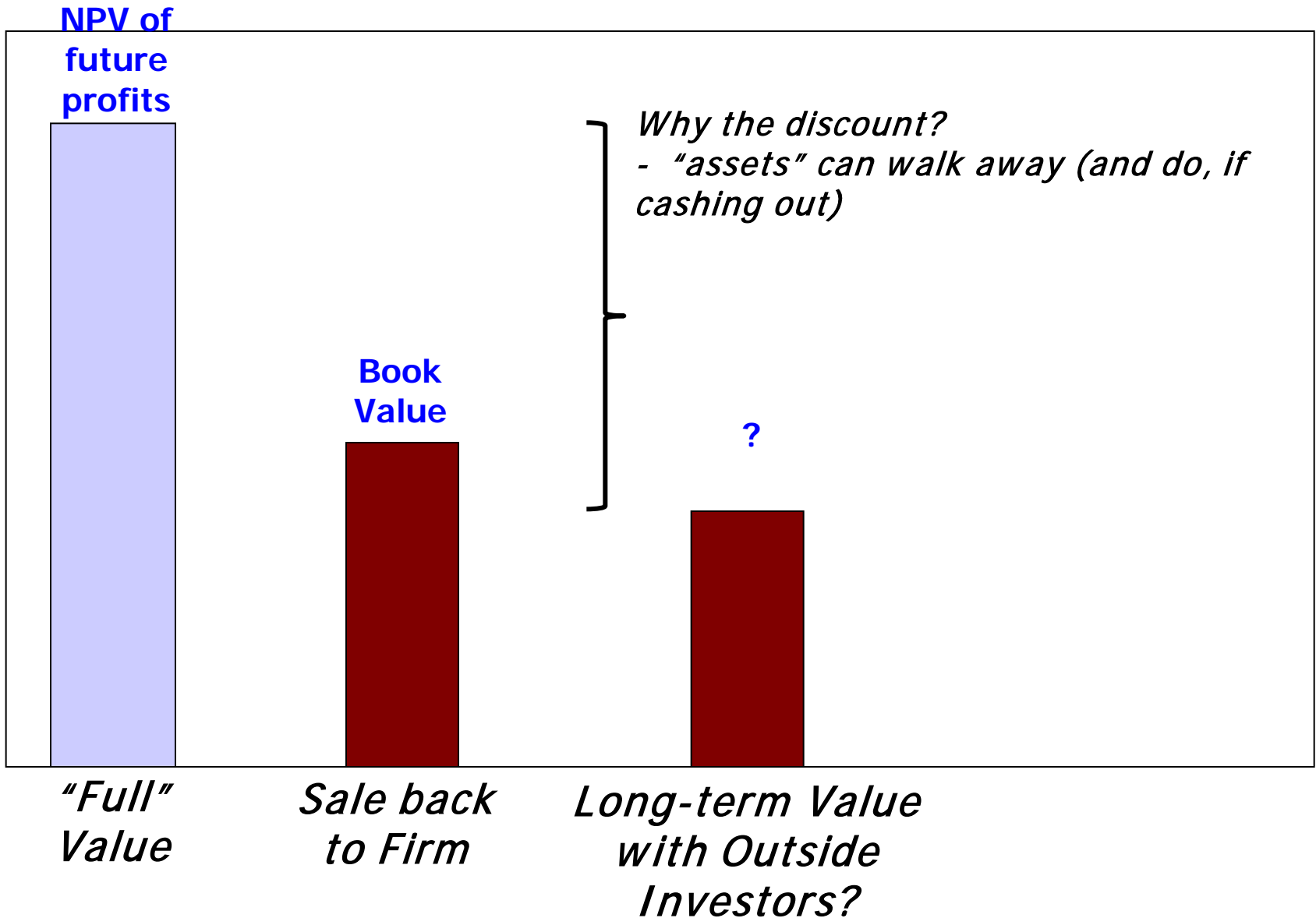
# Book Value "leaves a lot of money on the table"



## But won't these cause problems that hurt the firm's competitiveness long-term?

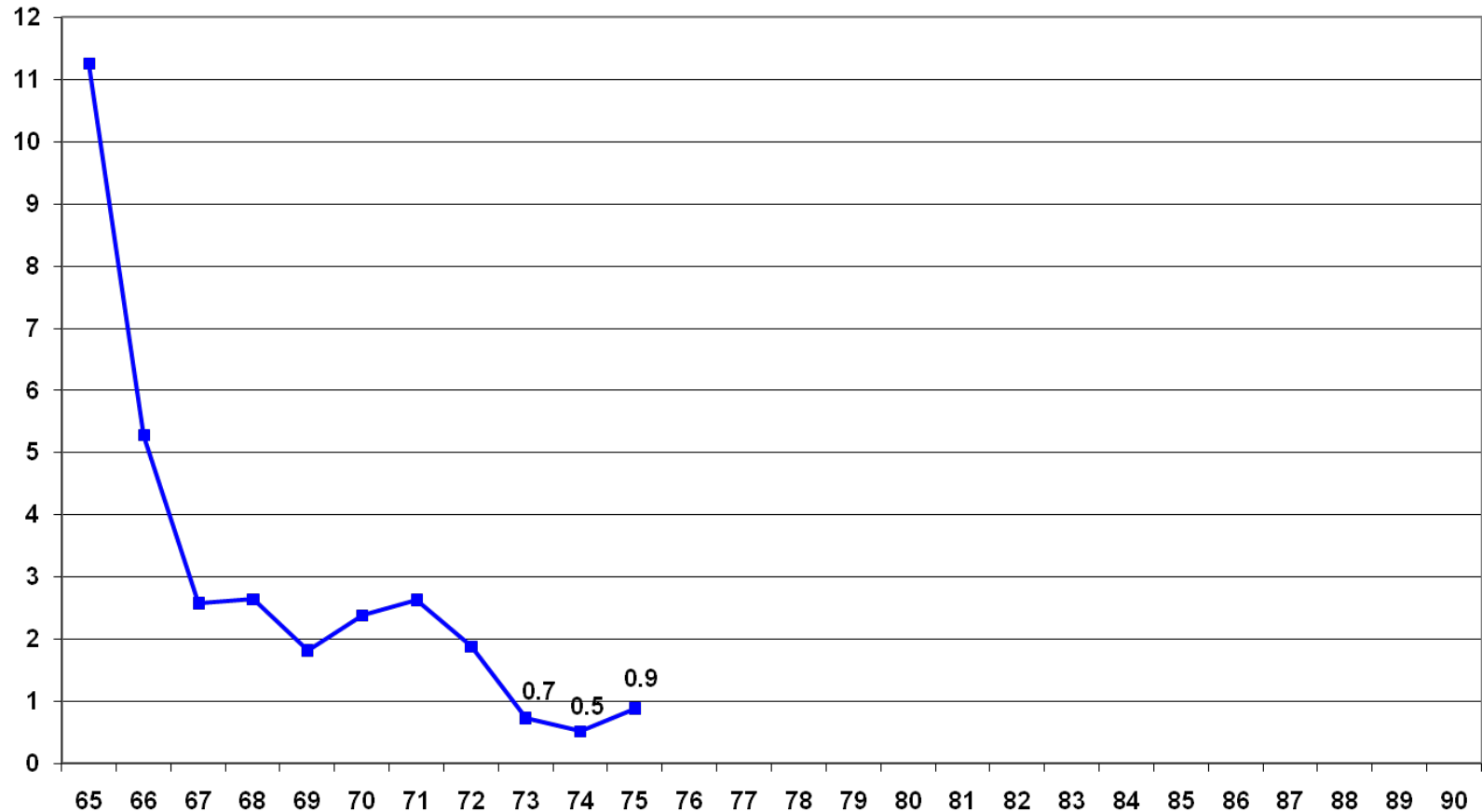
- Investment
  - expand scale and scope through acquisitions
- Diseconomies of scale in law?
- Liquidity & diversification (cash out)
- Key assets are leaving

# Maybe outside investment is myopic?



# This looked true for ad agencies ...

Median Ratio of Stock Price to Book Value  
for Public US Advertising Firms, 1965-1975



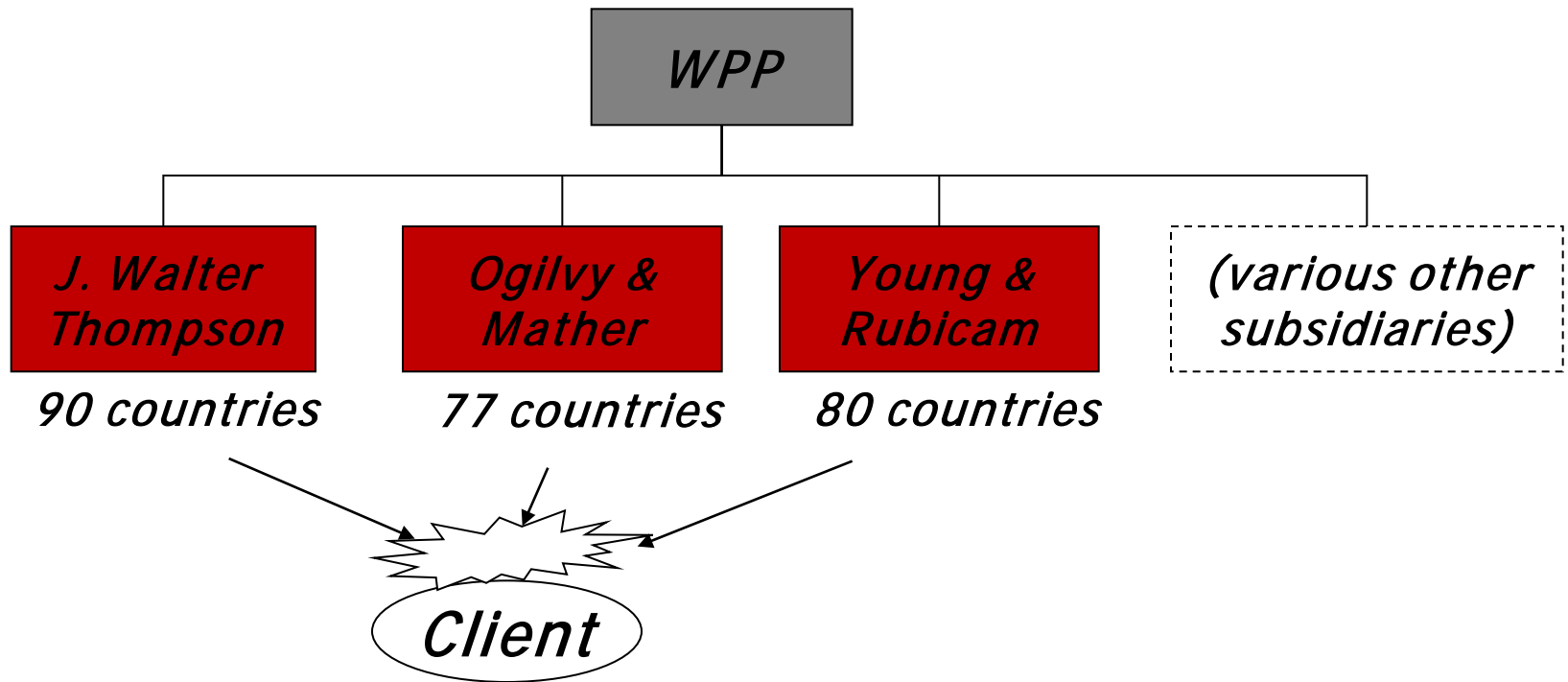
# Why might outside ownership happen and persist nonetheless? (part 1)

- Some firms will be more suited to public ownership – with firm size as an obvious but important factor
  - smaller ad agencies (and consultancies and investment banks) had more trouble as publicly-traded firms

# Why might outside ownership happen and persist nonetheless? (part 2)

- Emergence of new organizational forms to *intermediate* between outside investors and professional service firms
  - e.g., the Holding Companies in advertising...

# Holding Company (HC): owners of scores of highly autonomous – and competing -- subsidiaries

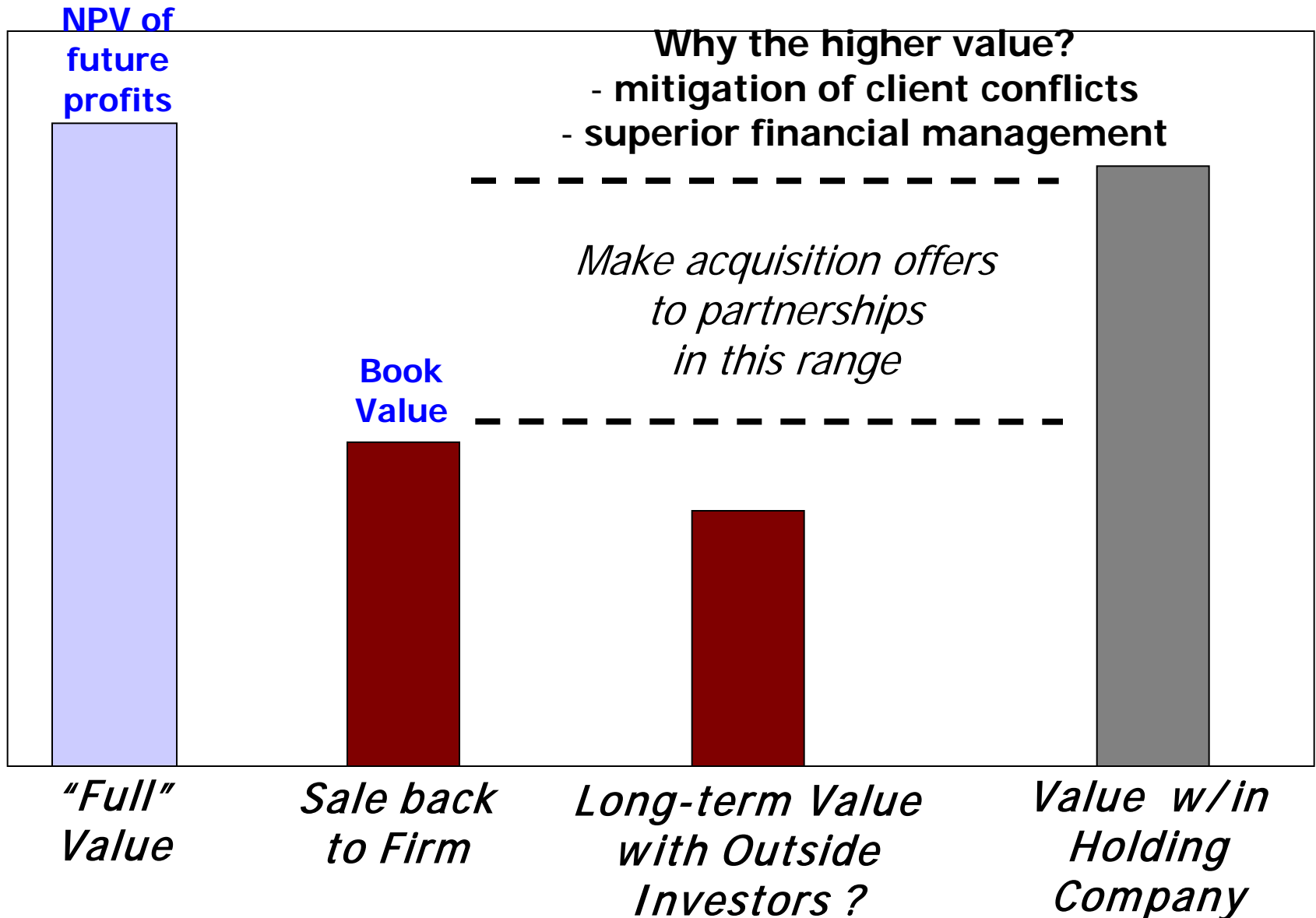


- By 2001, 45 of the 50 largest US advertising agencies were owned by four holding companies
- Puzzle = how do they add any value?

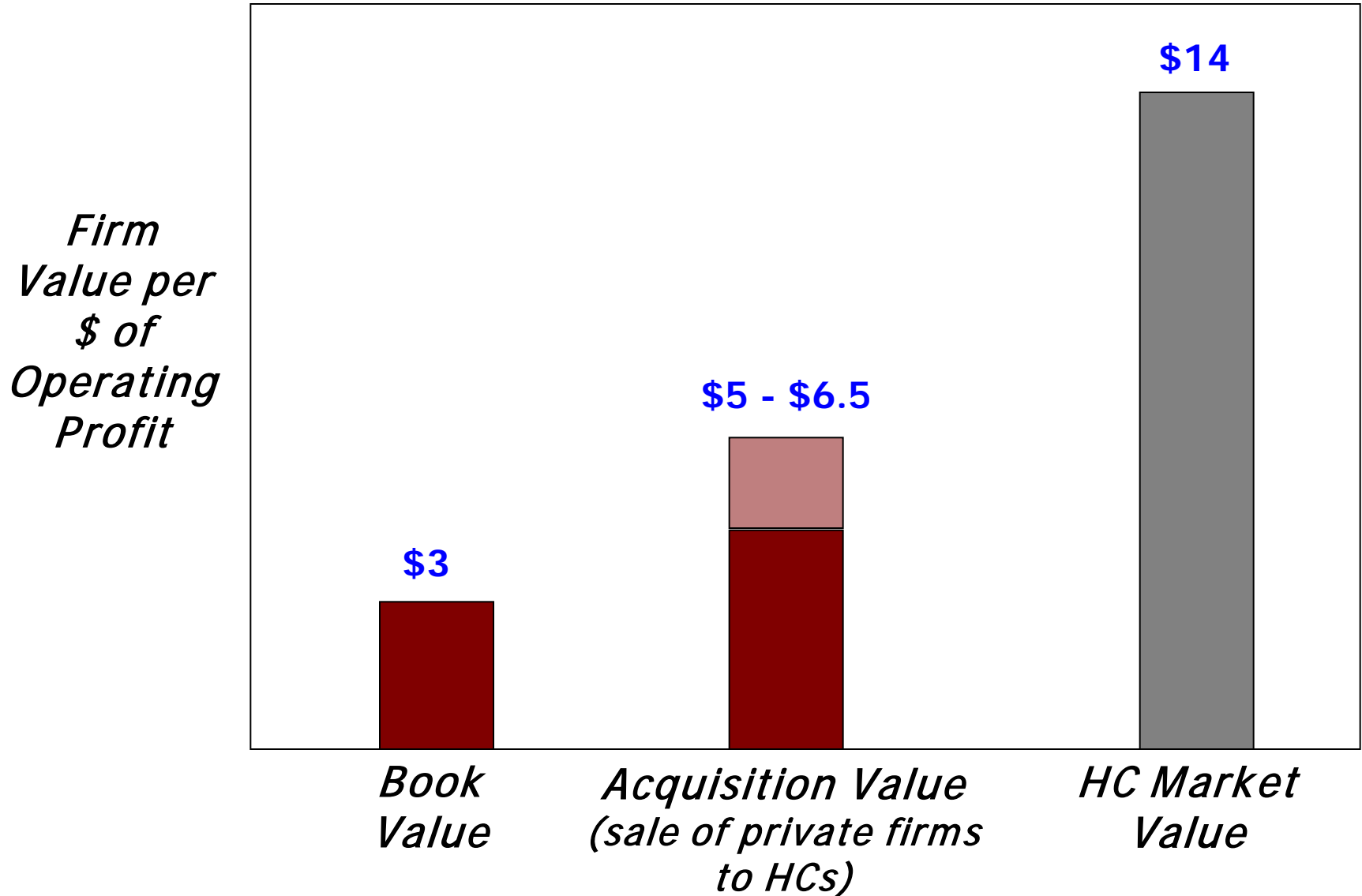
# How HCs add value: intermediation between capital markets and professional 'partnerships'

- Diversify across large clients by serving conflicted clients through separate subsidiaries
    - e.g., Heller Ehrman dissolution after two planned mergers scuttled because of client conflicts
  - Combine legal expertise with **financial and mgmt expertise**
- improve long-term value and reduce investor discounting ...  
giving opportunity to acquire independent firms profitably

# Intermediation by Holding Companies



## Example: Advertising in 2002



# So will Holding Companies consolidate Law Firms?

## Similarities to Advert.

- Value of outside investment for partner liquidity
- Perceived vulnerability to partner and client defections
- Client conflicts hindering diversification across clients
- Under-developed management systems

## Differences to Advert.

- Smaller average project size
  - Less internal division of labor
- ⇒ less “stickiness” to larger firms?
- More professional constraints (though decreasing)

# Concluding Thoughts

- Some law firms will certainly go public
  - Cashing out opportunity quite substantial
- Some of those law firms will even stay public
  - larger firms, where costs of outside ownership are lower
- Some kind of organizational innovation to intermediate between capital markets and partnerships is likely to emerge
  - maybe the holding company, maybe just changes internal to large law firms
- Acquisitions by these innovators may well catalyze substantial consolidation

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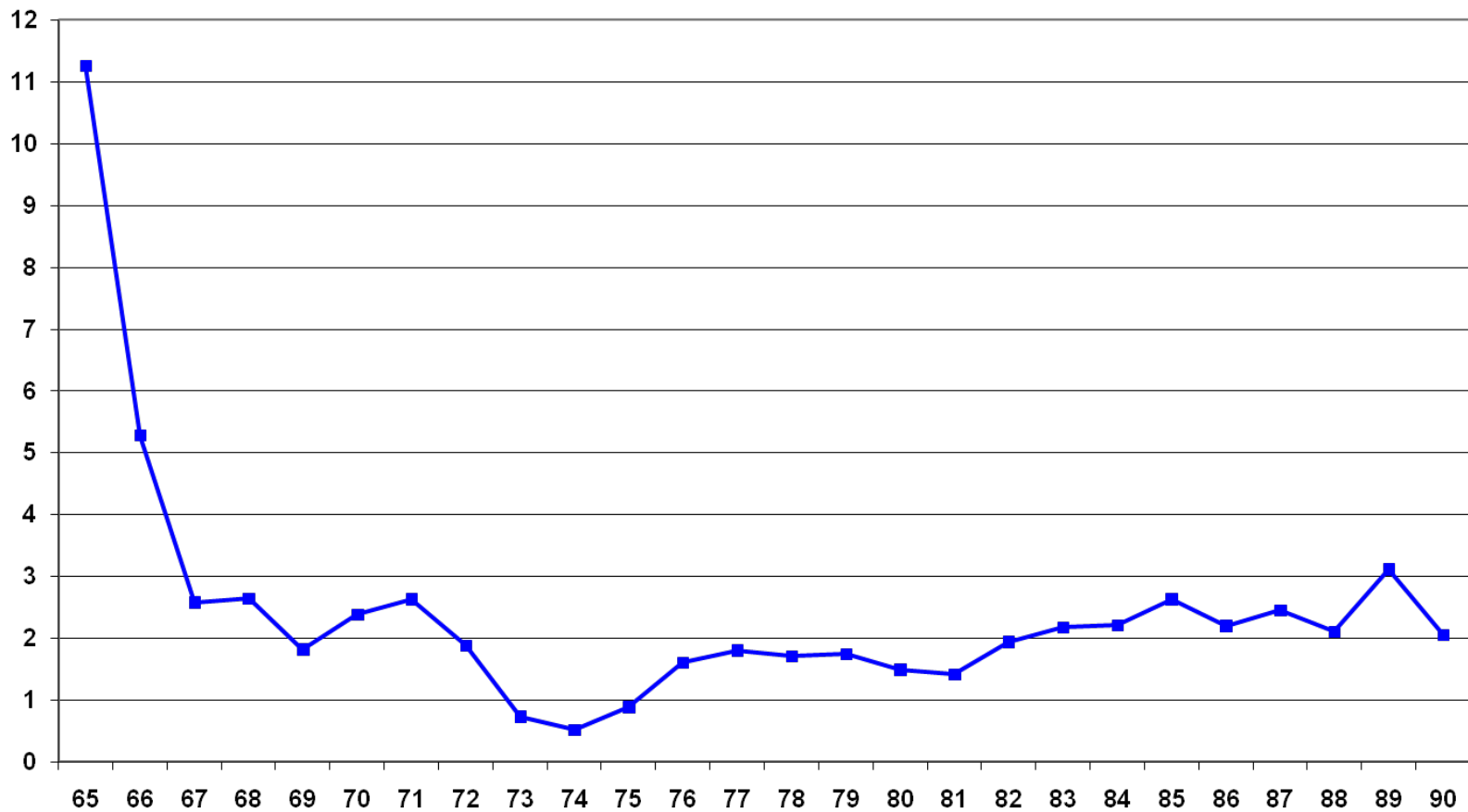
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# Values recovered after recession and small public firms exited

Median Ratio of Stock Price to Book Value for Public US Advertising Firms, 1965-1990



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## Differences to Advert.

- Smaller average project size
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=> less “stickiness” to larger firms?
  - More professional constraints (though decreasing)
- 
- Note: similar attempt has not (yet) succeeded in accounting
    - but HCs can't fully own partnerships and no client conflict to mitigate
  - Are client conflicts in Law substantial enough to warrant HCs?