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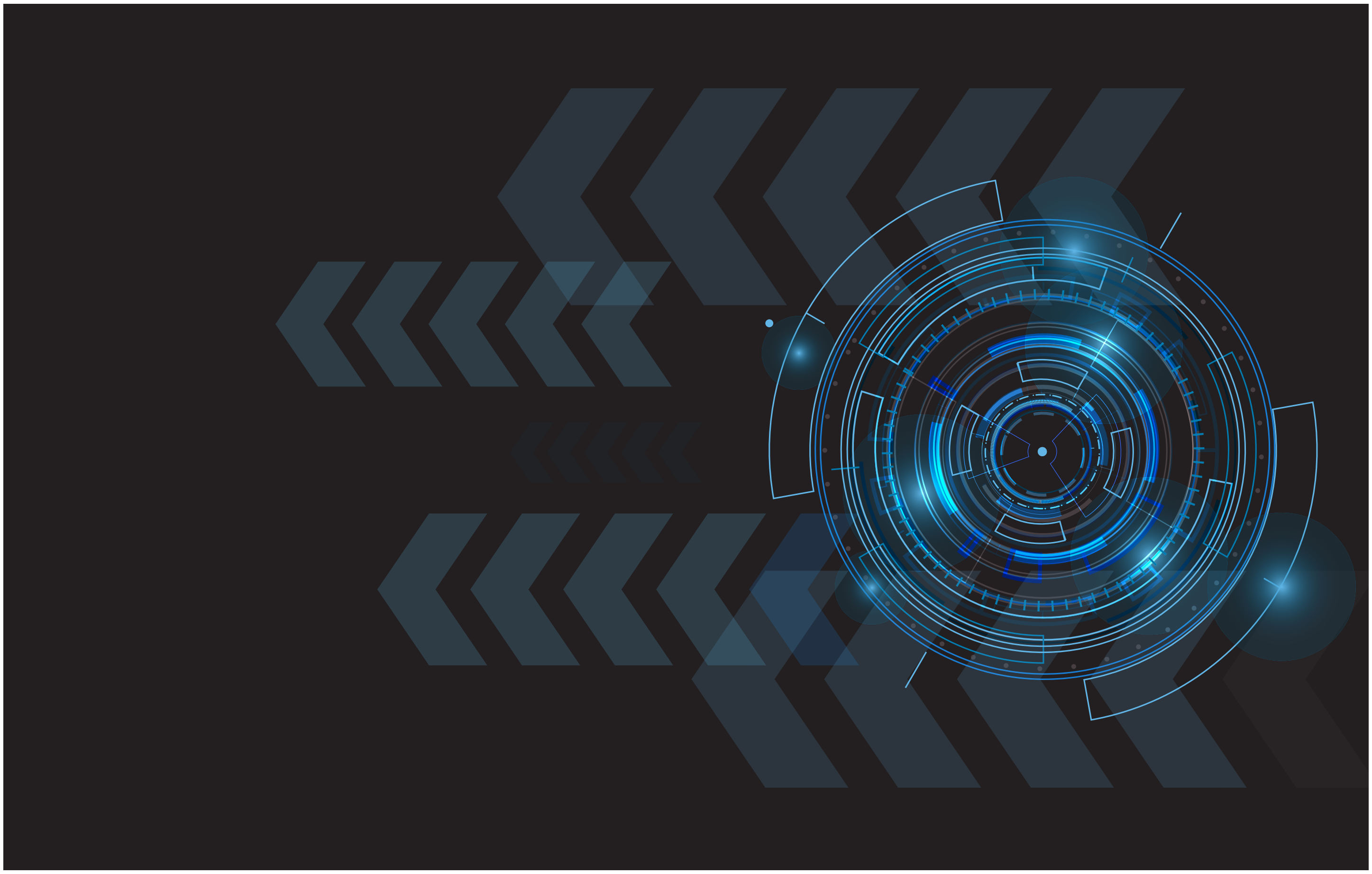

Point of view: Legal entity management—A critical component of growth

Businesses grow in different ways. Some types of growth are organic and tend to be ongoing, while others—notably, merger and acquisition (M&A) activity—can be inorganic and intermittent, infrequent, or even rare. However, regardless of the type of growth, the continuous management of a business's legal entities is a critical component of growth and an effective means of mitigating risk. Conversely, businesses that do not manage their legal entities on an ongoing basis—or at all—may face obstacles in achieving growth of either type, as well as varying types of risk.

Organic Growth and Legal Entity Management (LEM)

Organic growth can take many forms, such as geographic expansion, both within a country's borders as well as internationally; the introduction of new products or services that are outgrowths of those already in existence; and diversification into related industries. However, in these and other cases, it is critical to manage existing legal entities as well as the formation and maintenance of new entities to support and facilitate the growth of the business. In some cases, existing legal entities may be adequate to support and facilitate growth; in others, it may be desirable to form new entities. Once a decision is made to form one or more new entities, additional considerations arise, such as selecting the name, directors, and officers of each entity, the jurisdiction in which it is organized, and the type of entity to be created, as well as obtaining and maintaining necessary business licenses, such as licenses required to take on employees, and developing and implementing processes to maintain each entity's compliance and good standing. These considerations suggest that legal, compliance, and other support teams need to be involved at an early stage so that each new entity is able to "stand up" in a timely manner.

Similar factors need to be considered and addressed where geographic expansion is undertaken, but new geographies may require additional attention—particularly when expansion involves entering a new country or global region. In those cases, different laws or entire legal systems may apply, and different business and/or general cultures may lead to different outcomes. To navigate the complexities in the local regulatory environments in which an organization operates in, inclusive of jurisdictional compliance, organizations are often turning to global service providers.

Inorganic growth and LEM

Many of the challenges outlined above apply to M&A and other forms of inorganic growth. However, when a company is contemplating an acquisition—even a relatively small one—additional questions related to their legal entity management may emerge. Moreover, in situations where a company does not routinely engage in acquisition activity, the transaction itself can be extremely disruptive, thus complicating the mix of facts.

Some additional questions that may arise in the context of M&A deals include:

- How many new entities are we acquiring? Do we have the staff and other resources to maintain these entities? Do we need to form additional entities to facilitate the transaction and, if so, do we need to maintain them indefinitely? Do we have processes in place to eliminate redundant entities once the transaction closes? Do we have effective legal entity management processes and technology that can be relied upon post transition?

- Do our due diligence processes provide assurance that each of the entities we are acquiring is in good standing, has all necessary state registrations and business licenses? Do we have adequate resources to meet issues that may come to our attention as a result of the due diligence process?

- How do we navigate the situation where the company being acquired has legal entities in geographies where we've never operated?

Notably, some of the same considerations apply when a company is engaged in a disposition.

What to do?

The questions and challenges outlined above seem—and probably are—daunting. However, companies can take actions to address those questions and mitigate the challenges.

Policy creation

Planning and policies are essential. Developing a standard set of policies to be applied to the formation of new entities (and the maintenance or elimination of existing entities) can avoid having to treat every decision as a case of first impression. These policies can include matrices helping to address recurring questions such as the type of entity to be formed, its directors and officers, and so on.

Resource management

Companies should consider conducting ongoing evaluations of the resources—both financial and talent—available to maintain existing entities and stand-up

new ones, as needed. This can be a particularly vexing problem in jurisdictions where one person is expected to facilitate revenue-generating activities and to engage in LEM, because the former type of activity will almost invariably get more attention. And where additional resources are needed, companies need to consider whether those resources need to be "bought" (i.e., by hiring additional employees) or can be "outsourced" (to third-party service providers). The latter allows for companies to rely on the experience of the third-party service provider to assist with the organization's local legal entity management compliance which is subject to frequent change.

Ongoing monitoring

Companies should be aware of the potential implications of a "set it and forget it" mindset where LEM is concerned. It's easy for an entity to fall out of compliance. And a failure to engage in ongoing monitoring of legal entities can be unwise, as dealing with noncompliance only when an emergency arises can be more costly and more damaging, reputationally and otherwise.

Periodic assessments

An ongoing process to evaluate the elimination of legal entities can be equally or more important than having a process to determine when and how to form new entities. Some companies conduct annual reviews to determine which entities are no longer needed and can be dissolved or merged out of existence. This can be very helpful and can avoid the situation where someone looks at an entity formed years ago and asks, "why did we form this?" or "does it have any assets or liabilities?" Moreover, companies should also consider periodic LEM assessments to evaluate the efficiencies of their LEM processes and technology.

Conclusion

The above is a mere summary of some of the challenges that can result from a failure to pay sufficient attention to LEM in time of growth. Moreover, LEM is not a "one and done" activity that kicks in when growth plans are first launched and then recedes over time. Rather, it requires ongoing if not constant oversight, as legal, compliance, tax, and other requirements—as well as the organization itself—constantly evolve. A failure to address LEM can be costly in many ways, and can even limit growth, whether organic or inorganic. Companies should consider taking stock of their LEM activities and act, accordingly, using internal resources, the engagement of third-party service providers, or a combination of the two.

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