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Opening an Affiliated Business: Key Considerations

Some law firms have begun experimenting with affiliated businesses. While establishing such a business relationship may seem like a good way to generate additional income, several areas deserve consideration before a final decision is made.

Affiliated Businesses in General

An affiliated business is created when a law firm invests and plays some oversight role in a business, typically one that performs services complementary to aspects of the law firm's practice.

One firm, for example, has opened a business that provides human resources consulting services, including the administration of some HR functions; the law firm itself has a strong employment law practice. Another firm is affiliated with an operation that provides consulting services related to running offshore manufacturing businesses. That firm has an international law department.

Establishing a relationship with or opening an affiliated business can create synergy that can be generated to grow a law firm's practice. It can allow a firm to offer clients improved and broader service. And it can be used to enhance client loyalty and attract new clients.

At the same time, an affiliate that doesn't perform well can reflect poorly on the law firm. The firm also risks losing money as a result of entering a business it doesn't understand well. A law firm needs to take a hard look at the business under consideration, and realize that legal expertise won't necessarily translate into expertise in the particular field.

Areas to Consider

Before entering an affiliated relationship, a law firm needs to closely examine several vital areas.

Perhaps most important, an affiliated business should complement its law firm's core competency. In the examples above, the firms had proven proficiency in employment law and business consulting, respectively. If the business doesn't complement the firm's strengths, success is unlikely and the firm will, essentially,

be merely making an investment in another business.

Financing is another critical area. The law firm will almost certainly have to provide capital if the affiliated business is not already established. Whether it supplies cash outright or arranges financing through bank loans, the firm will ultimately be the one financing the new business.

In such a case, the law firm must realize that the affiliate will have no cash flow for some period of time; the duration of that period will vary by business type but the firm should count on at least six months, if not longer.

The affiliate should be clearly set up as a separate entity from the law firm. Thus, the firm probably should not be engaged in the management of the business' day-to-day operations, instead serving only in an oversight role. The executive function should rest elsewhere, usually with the person ensconced as the head of the affiliated business.

For similar reasons, the affiliate should generally not share the same location as the law firm. The business should be a separate legal entity, both on paper and by appearance. Further, a separate location may be necessary to avoid accusations that the affiliate is improperly practicing law.

A separate location can also mitigate any issues related to conflicts of interest, as well as help preclude liability for claims against the affiliate. In fact, a law firm would be well advised to check with its malpractice carrier regarding any additional liability risks prior to entering an affiliate relationship.

The law firm should also be concerned about the general impression that will arise from its relationship with the affiliate. To the extent a business is affiliated with a firm, it reflects on the firm. The firm must therefore consider carefully the impression that will be created (e.g., what type of business does it conduct? Will it look bad for the firm to be associated with such a business?).

Making the Decision

Affiliated businesses present an attractive option for increasing a firm's revenue, and may well deliver on this promise, but law firms shouldn't enter an affiliate relationship blindly or hastily. The costs in the end can prove far too great.