Legal Entity Rationalization
A Post-Merger Path to Sustainable High Performance
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Introduction

In recent years, many companies have seemingly chosen to respond to changes in market dynamics and increased competitive pressures by undergoing large-scale expansion. To help satisfy and support this growth, legal entities were created en masse as one means to that end. Consequently, as these entities age and outlive their intended purposes over time, companies may increasingly be faced with cumbersome, misaligned, or overly complex legal entity structures.

Because of the unstable nature of the current economic environment, companies today are placing a greater emphasis on balancing their desire for growth with more effective ways to cut costs and improve efficiencies. One way companies may be able to achieve this goal is to conduct a thorough analysis of their current legal entity structure and, if warranted per the results of such analysis, significantly reduce the number of legal entities that need to be maintained.

Simplifying a company’s legal entity structure, at a minimum, could lower the organization’s operating costs by reducing the time and effort required to comply with legal and statutory requirements. However, a company with a fully optimized legal entity structure can potentially create a sustainable competitive advantage as it provides a strategic instrument designed to create a more agile, streamlined, scalable and focused organization.
Legal Entities at a Glance

One of the more common reasons legal entities are created is to fuel growth—whether it is expanding organically in a new geographic region or developing a new business or inorganically through mergers or acquisitions. At times, creating legal entities can provide companies with the path of least resistance when the goal is to start business-as-usual activities as soon as possible. Operationally, doing so may make sense because it can take a substantial amount of time and effort to plan and roll out an optimal legal entity structure, whereas setting up a new legal entity may technically be as simple as submitting a few legal documents and paying an administrative fee.

While it may make sense to create legal entities in the short-term as part of an effort to propel growth, over time the legal entity structure could become burdensome and expensive to maintain and may cause the organization to be unnecessarily siloed, fragmented and complex. Because legal entities tend to be created to fulfill a specific immediate need, if the business or regulatory environment changes or if the company’s strategy or revenue structure shifts, the legal entity’s original intended purpose can effectively become obsolete.
A large multinational oil company acquired a smaller competitor in order to fill a perceived gap in its as-is portfolio of product and services offerings. Because there were significant overlaps in the two companies’ geographic footprint and product lines, the merger exacerbated the buying organization’s legal entity structure, which was already overburdened due to a long history of growth through acquisitions. Thus, when merger integration activities began, the timing was ripe for the organization to consider an enterprise-wide legal entity rationalization effort.

Because the company had never undertaken a large-scale initiative to reduce its legal entities, Accenture was engaged, due to its expertise in post-merger integration activities, to help drive its rationalization efforts. Working in conjunction with in-house Tax and Legal subject matter experts, Accenture used its leading practice Legal Entity Rationalization framework to help this organization diagnose its as-is organization structure, identify potential opportunities areas, conduct cost benefits analyses, develop rationalization strategies, and outline key work plan activities in an effort to reduce entity carrying costs and increase operational efficiencies.

As a direct result of the legal entity rationalization project, approximately 30 legal entities were dissolved that made up around 25 percent of the total legal entity population inherited by the company as part of the acquisition. This translated into significant cost savings in two ways: 1) reduction in recurring compliance costs required of all active legal entities and 2) elimination of the need to incur ~$500k per entity to build and configure a standard ERP platform on the legacy entities. Aside from these direct benefits, the company has also been able to realize operational improvements such as the reduction of effort associated with intercompany accounts, improved vendor and customer interface for contracts and invoices, and stronger cash liquidity due to less monies being tied up in capital reserve requirements. While this legal entity rationalization project can be seen as a success, there are ongoing plans to eliminate another 100 legal entities, which would further streamline the company’s organization structure.
Rationalization Benefits

Operating a company with an overburdened legal entity structure can be both expensive and inefficient. Thus, reducing the number of legal entities that a company carries might produce some of the following benefits:

- **Reduction in Compliance Costs**
- **Increase in Operational Efficiency**
- **Improved Strategic Agility**

**Reduction in Compliance Costs**
The annual maintenance costs for a legal entity can, in some cases, be substantial. In order to comply with a jurisdiction’s statutory requirements, a company may, for example (depending on the jurisdiction), be required to prepare and file regulatory disclosures, apply for licenses and permits, maintain legal and financial records, and perform internal and external audits for all of its active legal entities. By reducing the total number of legal entities, companies can potentially reduce the amount of time and money spent on compliance-related activities. In addition to these direct cost savings, fewer entities may also result in indirect benefits such as improved consistency and transparency of financial information and reduced risk for noncompliance with legal and fiscal obligations.

**Increase in Operational Efficiency**
Undergoing legal entity rationalization could also lead to gains in operational efficiency by reducing the number of intercompany accounts. This can help organizations eliminate activities and resources necessary to manage and reconcile intercompany transactions and balances. Similarly, the reduction of legal entities could help streamline the company’s interface with the market by presenting a single point of contact for each jurisdiction. Doing so may allow organizations to enhance their vendor and customer relationships, realize greater economies of scale, and simplify contracting and invoicing with their key partners.

**Improved Strategic Agility**
Beyond operational gains, an optimized legal entity structure can also serve as a strategic competitive advantage. Rationalizing extraneous legal entities can remove unnecessary reporting layers, hierarchies, and silos, which would provide companies with the ability to be more collaborative and enterprise-focused. Additionally, a flatter organization can potentially streamline communications between management and operations and result in the reduction of time required to make decisions and implement changes. Finally, a simplified organization structure may allow a company to strengthen its operating model by removing excessive complexity while increasing the alignment between its strategic objectives and business priorities.

Additionally, simplifying the legal entity structure may provide companies with the opportunity to manage and centralize their assets and resources more effectively. For instance, synergies from consolidation may be realized from standardizing system platforms, harmonizing salary and benefits programs, rightsizing the workforce, and/or reappropriating physical assets such as buildings and equipment. Further, as particular jurisdictions require active legal entities to maintain sizable capital reserves, reducing the number of entities could free up previously appropriated funds for other purposes.
Conduct As-Is Organization Assessment

To begin, companies might consider conducting a comprehensive assessment of their as-is structure. To do so, the project team would first define the company’s legal entity structures. Definitions of legal entity types (i.e., tax holding, captive finance, sales and marketing, etc.), status (i.e., active, dormant, in liquidation, etc.), capabilities (i.e., R&D, IP ownership, manufacturing, etc.), and limitations are among the building blocks to creating a robust assessment. Aligning definitions between key stakeholders is important to accurately reflect and consolidate a single source of truth for all legal entities.

Once legal entity definitions have been agreed upon, the project team can then begin collecting data points for each one of the company’s legal entities. For enhanced effectiveness, typically a combination of surveys and interviews might be deployed and carried out and the subsequent results captured in a central matrix. After all the data points have been collected, the project team would sort through the responses and inspect, cleanse and perform analysis to extrapolate insights and highlight key information to help support decision making. At this point, metrics, KPIs and dashboards should be developed as part of a program to measure progress and define success.

Design Optimal Legal Entity Structure

The design of an optimized future state legal entity structure may be thought of as contingent on developing a comprehensive roadmap to better enable key stakeholders across the company to plan and execute a path to achieve their objectives. The roadmap development process is iterative in nature as it is driven by continuous back-and-forth dialogue and alignment between (for example) the steering committee, Tax and Legal subject matter experts, legal entity P&L owners and project leadership. Roadmaps can be developed with the ability to categorize and lay out the footprint for legal entities that are targeted for long-term planning and future additions or as candidates for closure or needing more research.

Roadmaps can link business strategies to future actions and aim to explicitly outline the company’s optimal legal entity structure given an ideal state. They represent a best-case scenario where no obstacles stand in the way of implementation. However, in reality, there are many constraints to what is feasible. In an effort to move closer to reality, after the ideal state roadmap has been created, the project team might then consider socializing the results with all key stakeholders. During this step, the roadmap may be updated as new information is gathered. Typically, the validation process is more effective when conducted through a series of workshops. The participants of a workshop might be geographic or business-unit based and cross company lines from a functional standpoint (i.e., Tax, Legal, Operations, Finance, etc.).

Some of the concerns that can arise during validation involve the feasibility of rationalizing certain legal entities. For example, it may make perfect sense from an Operations standpoint to combine two legal entities that are largely redundant, but from a Tax perspective, keeping the legal entities separate may have strategic importance. Workshops can allow stakeholders to voice their concerns and exchange dialogue in order to decide what is best for the company as a whole. For the legal entity rationalization project to be better positioned for success, it is important that all key concerns be addressed during this stage before progressing further.

Accenture’s Legal Entity Rationalization
Perform Cost Benefit Analysis

Once all key concerns have been addressed, a cost framework might be developed that is designed to fully consider the business costs of rationalization against any potential cost savings. One approach to developing a comprehensive cost framework might consist of the following three steps:

1. Define cost categories in areas where direct cost savings can arise. Several possible examples of these kinds of savings include the following: 1) reduction of FTEs required to prepare tax filings, 2) reduction in external audit fees, and 3) rationalization of excess workplace resources.

2. Interview or survey subject matter experts in various departments across the company to help collect ranges for both potential direct cost savings and ongoing carrying costs as well as any additional rationalization benefits/costs for each legal entity within the company.

3. Using the collected data from steps one and two, build a cost model designed to project dissolution costs, payback period, break-even point, ROI and NPV based on the complexity and cost savings anticipated for each legal entity.

Due to hidden downstream costs or unanticipated complexities, it may not make sense to rationalize certain legal entities because the economics would not be net positive for the organization.

Develop Transformation Roadmap

Once key stakeholders and project leadership agree on which legal entities are to be rationalized, a work plan might then be developed to map out the path forward. In order to do so, the project team may consider working with subject matter experts across the company to determine factors such as the dissolution process, complexity, priority, timeline and effort required to rationalize each legal entity.

After detailed rationalization requirements have been gathered, the project team can then develop a prioritization mechanism based on resources available, operational impact, urgency to rationalize, and any other considerations to determine the order that rationalization will occur.

Then, for each to-be-rationalized legal entity, the project team could create a detailed work plan that includes tasks that each functional group within the organization would carry out as part of the effort to complete the rationalization process. For each task, the work plan can include items such as identifying the responsible party, estimated start and end dates, and columns for indicating issues encountered and resolution notes.
Leadership
Provide individuals with the responsibility to recognize and seek out opportunities when legal entities can be added or consolidated in accordance with the organization’s goals.

For example, in addition to producing accurate financial reports, the Finance organization might also be tasked with actively working to help minimize the amount of statutory reporting and audit spend. If opportunities exist to reduce this spend through rationalization, the Finance organization could propose it to the legal entity governance steering committee for evaluation. Every functional organization within the company could be tasked with a similar end goal in mind.

Organizational Structure
Form a legal entity governance steering committee with cross-functional expertise designed to provide a balanced assessment of the company’s legal entity portfolio.

The steering committee could be set up as a formal structure for the formation of relationships to better support decision making, foster appropriate culture and exchange cross-functional dialogue so that resources can be appropriated to further optimize the legal entity structure for the company. The steering committee tends to be comprised of leaders within the following organizations: Tax, Legal, Operations, HR, Regulatory, Treasury, Finance and IT. It is led by an individual who presides over discussions and makes final decisions as to what is best for the organization.

Process Management
Implement a formal process to periodically evaluate the company’s legal entity structure and provide recommendations for future changes.

Effective process management can require regular reviews by the steering committee to evaluate the general health of the company’s legal entity structure. One approach would be to structure the process so that addition/rationalization of legal entities can be approved only during these meetings. Typically, the steering committee meets on a quarterly basis or as business needs dictate. Additionally, guidelines and key performance indicators might be developed and articulated with clear goals and targets in place to define success. Checkpoints with the steering committee on the key performance indicators will cultivate discussions for issues that require escalations or buy-in.

With a governance model in place, a company may be better positioned to support its long-term legal entity strategy and sustain an efficient legal entity structure.

Once rationalization efforts have been completed and benefits realized, companies may choose to establish a governance model to manage new entities and reassess existing entities as business needs and economic environments shift over time. An effective governance model might consist of the following three aspects:
Additional Considerations

Although significant benefits can be gained by reducing the number of legal entities within a company, less is not always best in every case. Instead, situations may arise where it is both appropriate and necessary for organizations to explore the addition of extra legal entities in order to achieve the following:

**Reduced Startup Time**
When starting or acquiring a new business, adding legal entities can potentially allow companies to begin operations more quickly while experiencing fewer ramp up disruptions.

**Tax Benefits**
Depending on where companies are organized and operationally active, adding or shifting legal entities to tax-friendly jurisdictions may lower their effective tax rate.

**Limited Liabilities**
Having separate legal entities can potentially help to limit legal exposure for companies with operations in regulated markets or foreign countries.

Not surprisingly, there is no rule of thumb to determine the best number of legal entities that an organization should carry. Rather, a company’s optimal legal entity structure will likely shift over time based on factors such as the economic climate, regulatory environment, and its strategic goals and objectives.
Investors of a Fortune 500 communications and high-tech conglomerate demanded that the company cut costs and improve its operational efficiency. A significant driver of the high cost structure and inefficient operations was the company’s increasingly complex web of legal entities, which was due to its strategic focus on growth through acquisition. As part of the effort to meet the demand of the investors, Accenture was brought in to help identify rationalization opportunities within the company’s legal entity portfolio in order to decrease costs and streamline operations.

The Accenture team successfully provided the company with the tools and expertise required to reduce costs and increase operational efficiencies, in part by focusing on only maintaining essential legal entities. Accenture’s efforts helped lead to significant consolidation within the organization that helped the company achieve a legal entity portfolio size and overhead costs that were comparable to industry standards. In addition, the insights that Accenture provided to the company for each legal entity’s capabilities contributed to the organization’s ability to consolidate its operations and pursue global opportunities more efficiently.

In order to help the company realize its end-state goals, Accenture worked with the company to identify the capabilities of each legal entity, create an overview plan designed to achieve an efficient legal entity portfolio, develop a cost analysis framework, and implement a governance model that was structured to help manage the execution of operational processes to optimize the company’s legal entity structure. These actions empowered the company to reduce costs, streamline operations, and compete more effectively in the global market.
Summary

In today’s economic environment, a company should understand that it can ill afford to support an overburdened legal entity structure. However, what remains unclear to many is what an optimal legal entity structure looks like and the steps organizations need to take to get there. Because there is no one-size-fits-all approach, legal entity rationalization is frequently a highly complex, iterative and involved process that is neither quick nor easy. Although it can be a difficult goal to accomplish, a company that is able to successfully optimize its legal entity structure may be better equipped than competitors to achieve its strategic objectives and sustain long-term high performance.
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