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PRACTICE**

Is It Time to Increase Partner Capital Contributions? (Part II)

Partner capital can be a valuable financial resource for your firm's new funding needs. In Part I of this article series, we explored three common objectives that typically demand additional firm capitalization: pursuing growth, investing in technology, and improving billing and collections. Structuring partner contributions to complement your firm's capital needs may be a more attractive option than bank financing, particularly with economic trends that seem to indicate increasing, not decreasing, interest rates on the horizon.

ASSESSING CAPITAL REQUIREMENTS

How much capital does your firm need to maintain its operations and pursue strategic objectives? Working capital typically finances a firm's immediate cash needs and should be sufficient to avoid any cash flow problems. Firms typically experience money gaps when expenses are paid before payment is received for

services rendered. Add to this drain on cash flow, outlays required for growth initiatives or technology, and firms may find themselves searching for capital.

Two primary sources of firm capital are partners and banks. In planning capital structure, it is important to assess the amount of debt your firm can reasonably assume. Partner capital, the after-tax money that partners contribute toward financing a share of the firm's operations — may alleviate some debt burden. Relying too heavily on

lender capital can threaten the financial health of your firm, particularly if revenue falls while debt grows. This may happen seasonally, during slow times, or be the unfortunate consequence of a sluggish economy.

Some firms project their working capital needs based on expenses for a certain period, say, three to five months. Added into this calculation should be leeway for any planned growth or technology initiatives and a cushion for unexpected events that

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800 433 2292 P • 978 777 5929 F
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The Economics of Space: Buying vs. Leasing

Any firm that outgrows its office space or needs to relocate inevitably must weigh the benefits of buying vs. leasing. The real estate market has shot up dramatically in the past couple of years. And while the economy remains somewhat sluggish, interest rates hover at historic lows. As you decide whether to rent or own, it is important to look beyond the market conditions at the specific needs of your practice in the short and long term.

Property typically appreciates in value and can be a great investment over time, but ownership has financial challenges and management responsibilities that your practice can avoid by leasing. Both options have advantages and disadvantages that may affect relationships between partners and the fiscal health of your firm.

TO RENT OR OWN?

Whether you build from scratch or find a pre-existing space that suits your firm, you will have the most control if you own the property and are not bound by the constraints of a lease. Landlords often limit the ways in which a space can be altered, and these restrictions can be frustrating for firms anticipating or experiencing growth. One compromise scenario is to lease unfinished space with the potential to design and build the interior to suit your firm's needs.

Leasing also offers the flexibility of a short-term commitment if you feel your space needs may change

several years from now. Property ownership carries more financial risk. Real estate is a relatively illiquid asset and subject to market fluctuations. Needing to sell in a soft market could be costly. Or, if you rely on income from leasing, you become subject to occupancy risk. Should you own in an area with a glut of commercial space available, it may be difficult to rely on tenant income.

Many landlords use rental income to cover property management and maintenance costs. If you are a tenant, you are free from these responsibilities, but pay operating expenses — this can add little to any profit the landlord hands into the bank. If you are an owner, you are responsible for the “landlord duties” but avoid leasing overhead.

Leasing or owning property has significantly greater financial potential than leasing. However, in the short term, renting has its advantages, the most immediate being the lower initial outlay of cash. The cost of several months' rent and a security deposit is generally easier on cash flow than a substantial down payment for property or an outright purchase.

For tax purposes, rent is deductible as a business expense. The tax benefits for property ownership occur over time and may include annual depreciation and interest-

paid deductions. We can help detail the specific benefits for your firm.



PARTNER CONSIDERATIONS

For law firm partners, the real estate equity that accumulates over time can lead to valuable planning options, but there are also important considerations. Buying into real estate can place a significant financial burden on younger partners who may lack the capital to invest. On the other hand, complications may arise if an associate becomes a partner but is not offered an opportunity for real estate ownership. Either of these scenarios has the potential to create unwelcome tension between partners.

In certain instances, the viability of the firm could be at risk as well.

Leadership — Building Stronger Practices

Motivating the people in your firm to perform at top levels is most likely an ongoing objective. Once you attract the best and the brightest, the challenge becomes keeping them and effectively utilizing their skills to enhance and grow your practice. Competitive benefits and compensation are great retention tools, but what about influences that transcend an individual's bottom line, like leadership? As a strong leader in your firm, you can enhance both commitment and performance, as well as define the work culture of your firm.

Leadership plays an essential role in all successful organizations, from governments to Fortune 500 companies to baseball's World Series champions. And, it has a place in your law practice. Professionals who are highly skilled rarely benefit from heavy-handed management, but strong leadership can inspire them. And with motivated people working with you, you position yourself to more effectively sustain your daily

operations and affect positive change for the future of your firm.

Charisma is often the most notable trait of a leader, but not necessarily the most effective. You may achieve powerful results by tapping the following qualities:

- **Vision.** Defining short- and long-term objectives establishes direction for the firm. When you communicate your vision, you create a culture of inclusion. People feel they have a stake in the future, and are more likely to play in the firm's success. In this atmosphere, it is much easier to tap your human resources and develop strategies to accomplish your goals.
- **Humility.** While leaders benefit from having confidence in their abilities, arrogance can have a negative effect on morale. In contrast, humility cultivates respect and fosters an environment where self-interest takes a backseat to shared objectives, where one

person's accomplishments are everyone's success.

- **Integrity.** It is easier to motivate people when they trust your motives. One of the best ways to lead is by example, holding yourself to the same standards you set for others. People tend to thrive when they feel supported, when they feel you are rooting for their success rather than waiting for the future. Make a concerted effort to acknowledge the contributions of others, maintain a consistent sense of fairness, and take responsibility for your actions and decisions.

Leadership styles vary, and successful strategies will run the gamut from firm to firm. The challenge often lies in recognizing and addressing the psychological aspects of the workplace. Energizing and mobilizing the people in your practice with strong leadership will inevitably have a favorable impact on profitability and growth.

The Economics of Space: Buying vs. Leasing

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Depending on the structure of ownership, complex valuation and buy-out issues may result when partners leave or retire. For example, suppose a retiring senior partner wants to cash in on his or her equity interest as a source of retirement income. Without prior planning,

this demand could place a significant financial burden on the firm.

The best choice regarding buying or leasing will depend on many factors, particularly your firm's short- and long-term objectives. As property values increase, partners who own

real estate could experience a significant return on their investment, but preparation is key. If you find your practice needs more space, feel it's time to invest in real estate, or are itchy for a change, call us to explore the planning options for your firm.

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may affect revenue such as the loss of a client. After a realistic assessment of your firm's capital requirements, it will be easier to determine how much should come from the partners and how much should stem from other sources.

STRUCTURING PARTNER CONTRIBUTIONS

Once the amount needed from the partners, collectively, has been estimated, the next step is determining the amount each partner should contribute. Firms vary in their approach to capital structures. Some practices expect all partners to contribute the same amount, which

puts a greater burden on those who earn less because they must contribute a larger percentage of their income than those who earn more.

One technique that eliminates this disparity bases each partner's capital investment on his or her earnings. For example, a partner who earns 5% of the firm's income contributes 5% of capital, whereas a partner who earns 7% of the firm's income contributes 7% of capital. This method assumes that a partner who earns more uses proportionately more of the firm's resources and typically involves annual recalculations as earnings may fluctuate from year to year.

Firms generally collect contributions either in full, or over time. Partners required to pay in full may have to borrow from a bank. In these instances, it is common for the firm to then guarantee the loan.

There is no winning formula that will work for all firms. In addition to the financial benefits of partner capitalization, another less tangible, but notably beneficial, aspect of partner capital is retention. Partners who contribute may feel more loyal to the practice and more invested in its success. Call us for more information on how partner invested capital can work best for your practice.

News In A Nutshell

WORMS: IS YOUR FIRM PROTECTED?

My Doom. Netsky. Bagle. These ominous names represent computer worms that have wreaked havoc on systems nationwide. Similar to a virus, a worm is a malicious computer program that self-replicates and that may do so using e-mail or some other network connection. In the worst-case scenarios, worms are more than just inconvenient — they allow hackers access to your computer.

There are key safety measures your firm can take to protect its computer systems:

- Install anti-virus software that protects individual workstations, as well as servers, and keep it updated.
- Use firewalls to protect your network from unauthorized use.
- Secure remote connections to your firm



using virtual private networks (VPNs).

In addition, individual computer users should take the following precautions: open only familiar e-mails, be cautious opening e-mail attachments, and only download information from trusted websites. A strong offense may

be your firm's best defense against damaging security breaches.