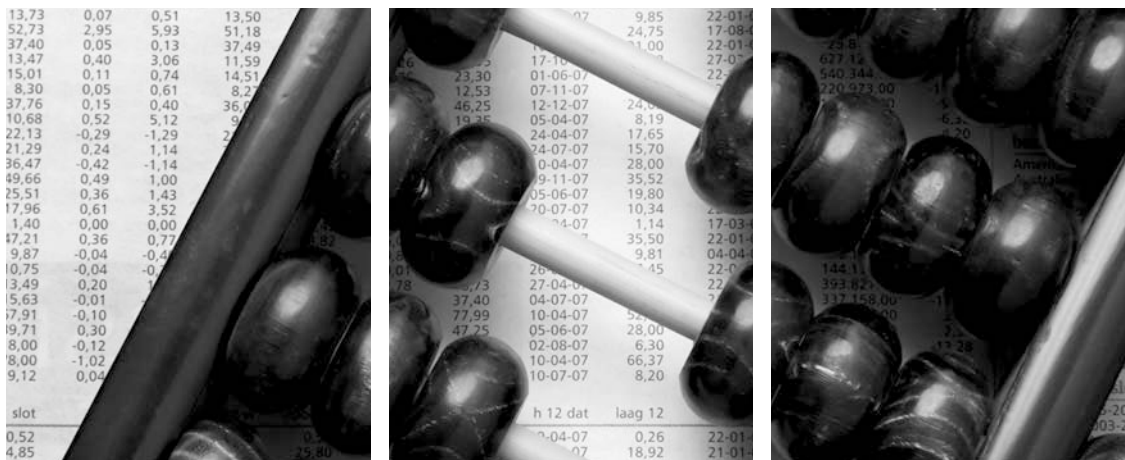


# Cash Management for Law Firms

BARRY WILKINSON



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## Executive summary

WITHOUT CASH, businesses die.

While cash management has long been the ultimate discipline in any commercial enterprise, this has not been the case for law firms. The consequences of poor cash management have been far less severe for them than for other businesses – they have usually been able to compensate shortfalls in cash flow by increasing the overdraft. They have been insulated from wider commercial reality by a combination of factors which have made bankers keen to lend to them, to a degree that they would otherwise scarcely contemplate. The factors which have made banks favour law firms as good candidates to which to lend money are:

- Law firms have been seen as a low-risk sector;
- Historically, firms have been profitable, and as a result, banks have experienced minimal losses with firms of all sizes;
- Joint and several liability, often amongst wealthy partners, has reduced the risk profile even further;
- Law firms have had control over substantial client account balances – when these are placed on deposit, they provide a source of lending capacity, which enables the banks to fund their own business. These balances have been keenly sought after as banks have a holistic view of their relationships with law firms; and
- Law firms have been a source of good business and introductions for the banks, giving them access to referrals.

We can safely say that these insulating factors have been greatly eroded. Many larger firms have weakened the covenant by converting to LLP status. The swiftness and severity of the recession have reduced the sector's profitability. Client account balances are much diminished, particularly for those firms which were strong in residential property. In times when banks have reduced their capacity to lend, even to existing customers, access to referrals is of limited benefit, at best.

The economy has shrunk and firms are having to adjust to the new reality. They have to manage their finances internally – minimising lock-up (work in progress, debtors and disbursements) and thereby their capital requirement – through far more effective systems, processes and resource allocation. But even that is unlikely to succeed without a change in culture and mindset that values collective cash flow at least alongside individual billings. Partnerships are inherently political entities, and in normal times, politics will often outweigh economics in decision-making and resource allocation. In a recession, economics can outweigh politics and that requires a far greater adjustment than the simple installation of processes and techniques. Profit is an opinion, while cash is a reality. Lock-up must be realised to keep the cash flowing and the lenders on-side.

Having minimised the funding requirements, these need to be structured to reflect the underlying assets. Overdrafts

are designed to fund the cyclical fluctuations which apply to all businesses – including law firms – but they are not permanent capital. Other structures (and sources), probably more expensive, may be needed.

Funding in 2009 is scarce. Some previous sources have disappeared and the process of granting facilities is far more intrusive. Bankers no longer consider law firms to be risk-free, therefore the firm's relationship with lenders is crucial. They need to be courted, managed and above all, communicated with. They are far more concerned about the firm's future than its past – hence forecast models need to be robust and projections need to be delivered.

Bankers are still keen on doing business with the legal sector, however. And this means that they will concentrate their lending in future on firms which display the best prospects and have effective cash management disciplines.

This report aims to help the reader to address the underlying issues in managing cash requirements, in order to retain the support and confidence of funders, so that firms can continue to pursue the right business strategy even in difficult market conditions.

Chapter 1 provides an introduction to the issues addressed in the report, outlining history and background. Chapter 2 goes on to examine the key elements that impact cash management in a law firm, including structure, people issues, client relationships, suppliers, management processes, work types, work in progress and credit management. The significance of each aspect, and how it should be managed to improve cash flow, is outlined.

Chapter 3 looks at how different work types attract different levels of lock-up and advocates setting appropriate, achievable targets or standards.

In Chapter 4, the report examines performance review and improvement.

Simple, clear management information, rather than overly-detailed reports, is suggested as the most effective way of identifying and solving problems. Emphasis is placed on the importance of process.

Chapter 5 addresses the issue of assessing capital requirements over different time periods, using short and medium-term forecasting to identify and predict shortfalls that will require funding.

Chapter 6 examines the cyclical nature of cash flow in a law firm and the various factors which can exacerbate this. Some ways of reducing the amplitude of the cycles are proposed.

The management of outflows is addressed in Chapter 7, outlining the key costs and disbursements faced by law firms. The author suggests how these can be managed most efficiently to achieve smoother cash flow.

Chapters 8 to 11 focus on practical strategies for improving cash flow, addressing four core areas. Chapter 8 looks at partners and communication, Chapter 9 at clients and staff, Chapter 10 at information and performance management, and Chapter 11 at technique and process.

In Chapter 12, attention is focused on funding structures and matching these to the type of expenditure to ensure that the most beneficial rate and format are chosen. Chapter 13 goes on to examine firms' relationships with their bankers and highlights that communication is the most significant factor in maintaining a mutually beneficial relationship.

Chapter 14 looks to the future, encouraging firms to take a longer term view of their development and growth and suggesting some of the issues which are likely to shape the legal profession and its approach to cash management in coming years.

In Part Two, eight anonymised case studies illustrate key points raised in the

preceding chapters. The success of taking a strong (and sometimes radical) approach to cash management is highlighted, and again the importance of communication and united action is underlined.

## About the author



Barry Wilkinson is senior partner at Wilkinson Read and Partners, a consultancy firm that has been helping legal professionals to implement profitability, cash flow and sales improvements since the recession of the early nineties.

Barry's experience includes over 15 years consulting with professional service firms, and he has saved his clients millions of pounds in all parts of their cost structures and through creative cash-flow programmes. His underlying method of achieving these results is by bringing partners together to move their firm in an agreed direction. Barry's recent successes include assisting a client to reduce its lock-up by £270,000 in a six-week period, and helping another to generate £200,000 in profit over four months.

Barry is a fellow and former area president of the Chartered Institute of Management Accountants and, prior to founding Wilkinson Read and Partners, was finance director of various subsidiaries of the RTZ (now Rio Tinto) group, returning problem companies to success and profit.

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# Acknowledgements

I HAVE many people to thank for helping me produce this report to demanding deadlines.

The publisher's brief required us to not only use our own experience and expertise from our consulting business, but also to supplement this by primary and secondary research.

I must start by thanking my team at Wilkinson Read and Partners, particularly Michelle Walsh and Anthony Wilkinson who have trawled through our client files to find suitable examples which would illustrate, amplify or confirm some of the points made in the text.

While there are books and articles addressing the subject of law firm profitability, and each has short sections devoted to working capital and cash management, there is little detailed work published on management of cash and lock-up. As a result, we have combed through articles and magazines going back several years, but it is a sign of the internet age that some of the most useful material has come from blogs and websites. There are a number of extremely good blogs covering law firm management, which are mostly from the US – but they still use cash accounting and the 'eat what you kill' approach.

Primary research has been totally different. We have surveyed managing partners and finance directors, and we have interviewed managing partners, finance directors, law firm consultants in firms of all sizes and bankers both past and present. Without exception, they have proved to be extremely helpful and their input has often been very thought-provoking. As most of the respondents agreed to be interviewed under conditions of anonymity, they have offered a great degree of openness. However, I would like to thank two consultants for their specific input. William Arthur, now at Kerma Partners, is known to many professionals as the former head of global professional services banking at Barclays. As such, he was able to put the responses of the current generation of bankers into unique perspective. I am also grateful to David Gilmore at DG Legal, who provided great detail on the issues of accounting for, and managing legal aid funds. My best advice to legal aid firms would be to 'talk to David'.

I would also like to thank the publishers, Ark Group, for their invaluable support in the writing of this report.

Barry Wilkinson  
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