CLEAN UP YOUR ACT

BARRY DAVIES, PRACTICE DIRECTOR

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In a recent email discussion with a bank manager, I asked the question: "What level of overdraft are you comfortable with offering a law firm?" I received an instant response saying: "I'm happy to tell you that it's usually two month's fees." It was useful to know this information, but it led to further thoughts on working capital requirements, considering no two firms' financial needs are identical.

It's an age-old saying that turnover is vanity, profits are sanity, and cash is a reality (a little like an apple a day keeps the doctor away). But a far more grownup approach to financial hygiene is needed in modern times, particularly when just a few years ago up to 10% of firms were reportedly in financial difficulty. To successfully run a law firm like any other commercial business, a 'best practice' approach should be adopted that runs further than just decent financial reporting and the use of KPIs (important though they are).

Twice monthly fees might be fine for some firms, but if you're dealing with heavier litigation then such lucrative cases might run for years, not months. This will put a strain on your cashflow.

Ratio analysis should be used by each department to fully understand what level of financial lock-up is likely to occur by work type and how it can be improved. This should be calculated in financial planning to include cashflow forecasting. A narrow focus to offer just one area of legal work is a financial risk. It's essential to completely understand each service area you intend to offer and the likely cash conversion timeline.

What else can you do to manage the working capital of your firm?

Some firms elect to come together and benefit from cost-saving synergies as part of a merger to drive down costs and general overheads. Others may consider funding from finance companies to smooth tax payments over a longer period. Rarely do we see the use of debt factors in law firms, but they're not unheard of.

But there's more to improving financial hygiene than increasing your overdraft level and asking your finance department to press really hard on chasing debts. Traditionally, chasing clients for money was a taboo subject and asking for money upfront was almost fearful. Getting to know your clients better will help you work out when their payment run happens and when to send your invoice. Technology is a critical part of the process-engineering cycle and can be factored into this essential element of business information.

Pricing and reviewing the overall process of how you manage financial lock-up is another. More and more firms are engaging process cost and pricing consultants in order to improve the standardisation of cases and to template certain work types to improve business intelligence.

With increased competition from traditional firms, and emerging entrants coming into the market with a far more commercial focus, improving your processes is dependent on your people and their level of engagement. To successfully improve your financial hygiene, each sector manager (or department head) needs to act as the hygienist by delivering an environment of better health disciplines to their teams – because no firm wants the smell of bad debts lingering around the office. LPM

ABOUT

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Douglas-Jones Mercer SOLICITORS

Revenue: £3.5m

Corporate status: Limited company

30 fee earners, 50 total staff

Offices: Swansea