

Working Capital Management – Cash is King

By Bill Kirby, Director, Inpractice UK Limited

(Extract from Bill Kirby's monthly management section of Manchester Law Society's "Messenger")

We do not need telling that there is tremendous financial pressure in the market place. This has come on top of all the other pressures facing law firms – client demands for more competitiveness and value for money, them realising their value to the law firm, new entrants and price competition with clients wanting more for less and competitors offering similar services for less.

Twelve to eighteen months ago it was predicted by some industry pundits that maybe 4,000 of our 10,000 law firms may be seriously affected as banks realised that unsecured overdrafts in poorly managed law firms was a recipe for disaster. This was all before the credit crunch, major drops in volumes of traditional work and clients without the money or the willingness to pay.

“Better internal procedures can have a startling and positive impact in a relatively short timeframe.”

Andrew Hague, Partner at Howard Worth

It is also proven that poor working capital management doesn't just leave the firm with cash flow risks; it also has an impact on real profitability. Clients are more likely to pay up promptly on bills submitted when agreed and that match the service they understood they would get. Bills are more likely to be challenged if they arrive when not expected, are late or are if they are for more than anticipated.

I have seen firms with Lock Up (WIP, Bills and Disbursements) at 100% of annual fee income, so this is a big issue worth tackling. This month I have discussed the topic with Andrew Hague, partner at Howard Worth, Chartered Accountants. Andrew – who is Cheshire based and is a committee member of the UK200 Group Legal Committee - helps his clients to use financial modelling to predict the benefits of reducing their lockup.

The average lockup period from the UK200 Benchmarking survey for Solicitors is 139 days. This equates to over £157k per equity partner with an average fee base of £414k. If this level of lockup can be reduced through better procedures in the practice, cash-flow can be improved dramatically. For example a reduction of lockup to 110 days would yield an extra £33k of cash in the bank.

Andrew Hague

Andrew considers the introduction of UITS40 requiring income to be recognised as a 'contract for services' progresses, and before an invoice has been raised, to have been a working capital wake up call for many firms. This meant that many businesses, including solicitors and other businesses who work under service contracts, will be recognising income before an invoice has been issued to a customer and therefore before payment has been received. The additional tax burden of recognising fees and therefore profit earlier has affected many firms' working capital management.

Due to this, Andrew has seen many practices change their thinking and approach to cash flow. "One firm has been so successful in improving cash management they reserved sufficient working capital to enable additional pension contributions to be made, thereby saving further personal tax for the partners." This is far from the situation everywhere.

The UK 200 Group benchmarks its legal clients across a number of KPIs helping to develop standards and highlight anomalies. But it is management of the right ratios within an individual firm that counts.

Your accountants should be able to offer advice to assist with cash flow forecasting, tax planning and budgeting, and assistance with preparation of business plans, SAR compliance and courses for fee earners to educate them in improving the cash cycle.

Working Capital Management in firms starts long before a bill is raised for work done and believe it or not failure to comply with managing working capital can also have a very adverse effect on customer dissatisfaction. Too many complaints referred to Leamington Spa relate to billing in excess of estimates and a very high proportion is judged in the client's interest and real revenue is lost.

Lexcel and basic compliance rules are great aids and guides to what we have to do. Working Capital Management is not a job just for the finance team - partners and lawyers have a massive role to play.

The discussions that take place (and any other communication) pre-client and matter inception sets the whole plan.

- Providing an honest appraisal of the work to be done
- Explaining the likely costs and disbursements
- Estimating the % chance of success
- Issuing the Rule 2 letter and ensuring its signed return

These are in the rules but this environment gives the opportunity to discuss with the client a profile for billing – end of the case, monthly in £ chunks, case stages, on account and so on.

The shy lawyer can handle this “sensitive” topic by “extending” the rules to simply cover billing.

- Next the lawyer needs to ensure that the firm is aware of this profile – setting up a cost budget in the accounts system for the case, triggering warnings when WIP targets are being approached.
- Next make sure that time recording is working effectively, clients expect it. (I would argue that time even for fixed fee work should be recorded to help the next negotiation and compare performance within the firm.)
- Make sure the billing happens as it has been agreed with the client
- Be prompt – bill at the due moment or quickly at the end of the case
- Whether successful or not the client is more likely to pay the quickly produced bill – before he has had time to brood. (Had access denied or suffered a months maintenance loss)

Andrew Hague's details are available at www.howardworth.co.uk

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For further information on how we work with law firms, please contact Bill Kirby or Allan Carton

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