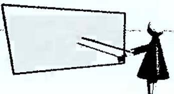
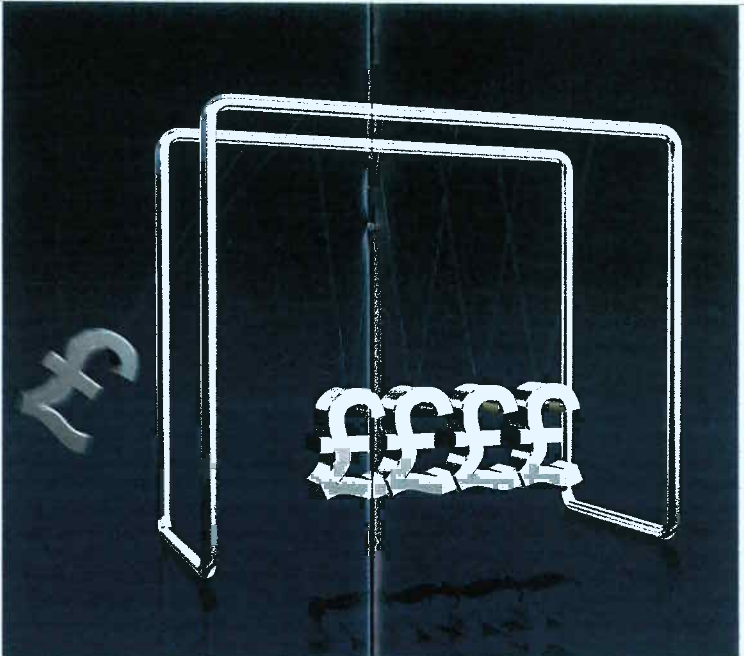


Cash management

Cash management: put the squeeze on your business

Cash management, to accelerate cash flow and reduce debt and partner investment, is fundamental to developing a law firm.

By Peter Scott, Peter Scott Consulting



Professional firms fail when the cash runs out. However, managing cash flow is not only about survival – it is also necessary for providing firms with the means to develop and grow so they can achieve their strategic objectives.

Managing cash flow is a difficult task and the typical challenges facing professional firms will often include some or all of the following:

- To pay partners' tax/the rent etc;
- To pay off/reduce borrowings;
- To pay partners last year's profits;
- To pay out retiring partners;
- To avoid having to contribute additional partner capital;
- To manage the risks associated with work in progress (WIP) and debtors.

Get your partners into shape

Cash flow involves dealing with money but in reality, as managing partners will tell you, managing the financial well-being of a professional firm is not so much about figures but all to do with managing the people in the business (particularly partners) to ensure they maximise their potential and the firm gets the best out of them.

How partners financially manage their practices tends to be a reflection of how they behave and perform generally as partners. On close examination, a partner's poor financial management will often reveal more fundamental issues of behaviour, attitude and an inability to manage client relationships, because financial performance is just the tip of the iceberg – it is the underlying causes that need to be tackled.

The starting point is to identify the cash flow log-jams and agree how they should be dealt with and by whom. It can be an uphill struggle to persuade partners to behave in a manner conducive to improving cash flow. Crack this hurdle and things frequently fall into place.

How often when I was a managing partner was I told by a difficult partner, "You can't tell me to do that – I own this firm as much as you do." That is a common experience.

Given that attitude on the part of some, improving cash management in a professional firm tends not to be so much about 'telling' partners what to do, but more about 'taking them with you', often by showing them that there is another, better way of doing things. But to get all partners going in the same direction may require fundamental shifts in behaviour on the part of some.

At the outset, try to focus on obtaining buy-in to the idea of 'partner accountability', evidenced if possible by each partner undertaking to support:

- The implementation of all decisions made by the partnership;
- Those managing the firm; and
- All other partners in the firm

(mutual support is the essence of partnership).

If anyone refuses to go along with this, then a different conversation will need to take place. Indeed, the objective of taking cash management onto a higher plane can itself be used as the catalyst for the issue of ***who in reality runs the firm*** and whether the partners are, when it comes to the crunch, prepared to be managed.

Put in place the 'right team'

Putting in place a finance team *fit for purpose* also needs to be dealt with early on. This begs the question, 'Who should be responsible for financial management?'

Some would suggest the finance director (FD) should take control of the function. However, while there are many excellent FDs in professional firms, my own experience has tended to show that a finance director cannot do it alone; he or she will need to be part of a larger team – a task force put together for the purpose.

Financial management and, in particular, driving cash flow should be a primary role for the managing partner, who will not only need strong people and communication skills, but also a strong financial understanding of the business. Most often it will be left to the managing partner to take partners with him/her and this will require leadership qualities that many finance directors, in the context of, for example, a law firm, may not possess. It is a sad fact of law firm practice that, however good a finance director, partners will often only listen to and have respect for another lawyer, particularly if he/she is also the managing partner.

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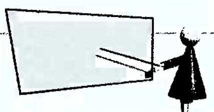
>
> Peter Scott, founder, Peter Scott Consulting.

Depending upon the size and nature of a firm, cash management may need to be delegated to those managing various groups in the firm, who together might make up the core finance team. Sometimes, unless responsibility for generating cash is pushed down in a corporate manner to line managers, it is unlikely that a managing partner and finance director alone can succeed in their tasks.

But how far down should delegation go? The philosophy in many firms is that individual partners should always be primarily responsible for their cash management and the trend in some firms is to emphasise this responsibility by linking distributions of profit to consistently meeting cash-collection targets. However, years of good profits can induce a feeling of complacency in some partners and the sanction of not paying out profits from last year may not be such an incentive for some. How many managing partners have experienced the situation, as I did, of a partner who has not cashed a distribution cheque after six months, so the cheque is out of date?

Other firms may take a different approach and consider that converting WIP into bills and collecting cash should not be left to individual partners, but centralised and performed by those most capable. A balanced approach somewhere in the middle may work best, whereby partners are primarily responsible but if they do not perform then those at the centre, in the finance 'task force', take over. Certainly, partners will need to be helped, directed and cajoled, and one way of doing this is to use revenue managers whose role is to manage both WIP and debtors. Credit controllers may do an excellent job within the parameters of their role, but a revenue manager, particularly if



sitting in a department or group and working closely with every partner and fee earner in that area, can help to make sustainable inroads into lock-up.

And sanctions may need to be imposed for consistent failure by partners to perform. Mention has already been made of linking profit distributions to cash collections. Some firms go even further – for example, as a managing partner I was given authority to stop monthly drawings if it was shown that a partner had processed a bill but had not delivered it to the client within a reasonable period of time, a practice that if widespread can cause serious problems for a firm's cash flow and its relationships with clients.

It is also crucial when it comes to 'making it happen' to harness the 'power of the team'. Constructing a loyal and able team to implement changes in the way a firm deals with its cash management can mean the difference between success and failure. The task-force approach, of putting together a hand-picked team, under a strong and purposeful leader, which is given the mandate to 'go do', can be extremely effective.

Having said that, any task force may need to be ruthless in overcoming internal resistance. A clear message may need to be communicated that there is no alternative to the new procedures and that partners not willing or able to change should seek employment elsewhere.

Keep it simple

Too many firms suffer from financial-information overload.

I see firms that produce financial spreadsheets that make your eyes glaze over – the end result is that such reports often end up in the waste bin. What is required is clear and regular financial information, ideally on a single page, which highlights the critical trends and areas of performance, and indicates what needs to be done. If much of this can be shown graphically, then it can be an even more effective way of providing relevant information and driving home the key messages.

Matters that will need reporting on regularly (often weekly) are likely to include:

- Input – the amount of chargeable hours being recorded, as against budget to enable remedial action to be taken if necessary;
- Aged work in progress – it amazes me how often I see firms that do not age their WIP. How is it possible to construct realistic billing plans if you do not know the age of your WIP? And the trend of WIP needs to be shown – if week on week it is increasing, alarm bells need to ring. For that reason, I advocate highlighting increases in WIP in red;
- Debtors – likewise, showing the trend is important so that problems can be nipped in the bud quickly before it is too late;
- Lock-up (WIP, unbilled disbursements and debtors) – why not publish 'lock up tables' showing each group's/each partner's lock-up and let peer pressure do the rest?

> Ultimately, if partners do not respond to the help and resource provided, then there is always the 'star chamber' approach used by many firms to good effect, whereby partners are required individually to account for their lack of cash management.

Get the basics right

Effective cash management starts when a firm takes instructions – if you get it wrong at this stage then you may forever be struggling with cash-flow problems. So:

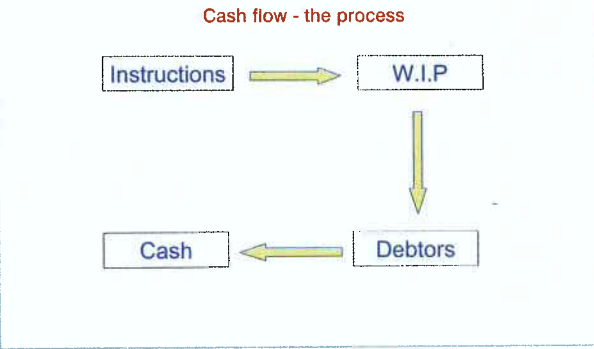
- Ask clients to fund disbursements and try to take realistic amounts on account of fees with agreement as to refreshers when the original money on account runs out;
- Agree with clients interim-billing arrangements as well as staggered billings throughout the month – delivering bills to catch clients' end of month payment runs can make a difference;
- Agree bills with clients before delivering them – experience shows that clients will often pay sooner if this simple step is taken;
- Agree payment terms once a bill is delivered – it continues to amaze me how many firms, having provided free credit to clients for many months then agree to extended payment terms that are subsequently not met;
- Whatever is agreed with clients, confirm it in writing.

Analyse your business

In order to decide what actions may need to be taken to accelerate cash flow, it is critical to first carry out a detailed analysis of every aspect of the firm's work and business. This may, for example, lead to the conclusion that a part of the business, however profitable on the face of it, must be dropped because it will always haemorrhage cash.

Develop a cash-generation plan

If generating cash is to be improved, then a cash-generation plan will need to be put in place, focussing on (in order of priority):



Source: Peter Scott Consulting

- Partner accountability (as discussed earlier);
- Rolling forward cash-position goals built around a minimum acceptable cash balance at the bank and the cash needed to cover all outgoings for the next three months (including partners' drawings and distributions);
- Realistic billing targets by partner/group based on aged WIP, planned to generate cash to meet future major outgoings;
- Cash-collection targets by partner/group, based upon aged debtors that are seen by partners to be reasonable and achievable and are broadcast weekly;
- Report and publish weekly on cash collection, recognising the consequences of deviations – for example, +/-£100k per week = +/- £1.3m per quarter. Leaving the monitoring of cash for periods of longer than a week (at most) risks losing control of the cash-collection process;
- Make payments to partners dependent on cash collection. This can be linked to overall collections or to individual/group collections. As mentioned above, publishing lock-up tables can be an effective technique;
- Support such a cash-generation plan with sufficient resource to ensure that partners are provided with the information and help they need to perform and to ensure that the absence of such resource cannot be used as an excuse. Employing revenue managers as mentioned earlier can be effective;
- Do not consider asking partners for additional capital as part of your cash generation plan – partner capital should not be used to subsidise financial underperformance. Firms should be lean and work at running their businesses on the minimum amount of working capital prudently required. The most efficient firms are constantly reducing their lock-up days by robustly taking control of their internal processes to manage down their WIP and debtors.

Ultimately, if partners do not respond to the help and resource provided, then there is always the 'star chamber' approach used by many firms to good effect, whereby partners are required individually to account for their lack of cash management.

Whatever techniques are used to accelerate cash flow, it is important to provide partners with realistic and achievable targets, otherwise it will be difficult to subsequently criticise and/or impose sanctions for failure to perform.

Implementation is the key to achieving success in cash management and while this will require financial discipline on the part of everyone and a willingness on the part of partners to be managed, other things may also need to change.

Taking control of cash generation may require a complete change to the culture of a firm and this process will need to be managed. This will not happen if a firm does not have strong leadership that is prepared to face up to 'sacred cows', to challenge accepted ways of doing things, to have the determination to drive through change and to take partners on the journey.

> Sanctions may need to be imposed for consistent failure by partners to perform.

How much is your lock up? Whatever the figure, it represents not only a risk to your business but also to the working-capital requirement of your business. Try to develop a realistic and achievable plan to reduce your lock up year by year, so that your hard-earned cash ends up where it should – in your pockets. ■

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