MACQUARIE RELATIONSHIP BANKING

MACQUARIE BANK

Growth matters

Executive summary

As we emerge from the challenging conditions of recent times, growth is clearly on the agenda for legal practices. But growth for growth's sake is not always a positive thing, and increasing revenue quickly can lead to cashflow pressures.

A recent survey of Macquarie Relationship Banking legal clients showed that 65 per cent expect positive growth this year. Smaller legal firms fared surprisingly well during the crisis, and started seeing increased activity as early as late 2009. But many firms experienced being treated as a 'third banker' by their clients, with an increasing lag in fee collection times.

So, how do you plan for this growth? What processes need to be in place to maximise profitability and partner returns?

Macquarie Relationship Banking recently held round table discussions with partners from smaller law firms around Australia. Their insights revealed the importance of planning ahead, and effectively managing cashflow so resources are in place to take advantage of growth opportunities.

Cautiously optimistic

Although the legal industry is conservative by nature and may view economic recovery with some caution, most practices are looking to grow during the coming year. Our discussions revealed firms are taking a diverse range of strategies, including acquisitions, lateral hires, new tenders or client pitches and cross-referrals between practice areas.

All growth strategies will have an impact on cashflow, and this needs to be managed and planned for. Funding for growth will commonly come from two areas – partner equity or the bank. So, without proper planning, business growth could actually reduce partner draws in the short-term.

Partner insights

"There are opportunities for smaller firms now, as many clients are trying to reduce their costs on the lower value legal work, and we can be more flexible."

"We're focusing on organic growth with our existing clients, and asking them for referrals to new clients."

"It's important to stick to your knitting – understand why your staff and clients like working with you, and stick with those core competencies."

"We need to get better at selling our 'value' story. As legal practitioners, our challenge is to prove we provide value for money – and perhaps develop our pricing models accordingly."

"I'd like to use our skills to get better quality work, rather than just focusing purely on growth."

Cashflow is king

Have you ever looked at your business and thought, it seems to be going really well, but I don't know where the cash is? In reality, cash is a fact, and profit is simply an opinion. Cashflow management is an important discipline – it is the lifeblood of your firm.

Partner insights

"We're now having discussions on how to increase salaries that were frozen, or promoting associates. But what is our financial capacity to do that?"

"'We're going gangbusters in all areas of the firm. We have the infrastructure and space so we're looking at engaging another firm to join us. They will complement our existing practice areas."

"Our biggest challenge is streamlining the process of work. Using technology, we can make our straightforward legal work, such as conveyancing, more efficient - and improve our margins"

Planning for growth

Bankers often tend to think about financials in retrospect – an annual review of profit and loss, for example. But at Macquarie Relationship Banking, we are more interested in assisting firms with future planning – where do you want to be, and what will be the positive and negative impacts of that on your cashflow and partner distributions?

At these round table sessions, we launched a new forward planning tool specifically designed to assist legal practices to understand the drivers of profitable growth.

It looks at the three key factors driving cashflow:

- What is your revenue?
- What is your profit margin?
- What is your lock-up period – how long does it take to convert a new file into a paid invoice?

Scenario 1: Stable growth in business

One of our clients is forecasting 15 per cent growth this year on their fee base of $5 million, thanks to a small increase in hourly rates and the promotion of some junior associates to senior level. They are still working on a profit margin of 30 per cent, and an average lock-up of 120 days.

Using the cashflow tool, we can demonstrate that they could increase their profits by $225,000, but would need an additional $250,000 funding to initially achieve that growth.

Scenario 2: New lateral hire

A client was looking at an option to bring in a new partner, who was currently earning around $1 million in fees on a 30 per cent profit margin. It seemed like a strong lateral hire.

He was mainly involved in workers compensation and family law, with a debtor's base of almost two years. The cashflow forecast showed that the partners would have to put in more of their own money to support the new partner, and retain their draws in the business. They decided not to go ahead with the hire.

If you grow and improve revenue without funding it, you actually reduce the amount of cash available in the business – for day-to-day operational expenses such as salaries, and for partner draws.

This is where Macquarie Relationship Banking can help. Because we know every situation is different, we pride ourselves on taking an individual approach to each client's funding needs. If you can see growth in your future, we'll work with you to understand ways we can fund the activities you need to achieve it. And we'll help you run the numbers to check it makes commercial sense. Our understanding of law firms for more than 25 years gives us insights into strategies and qualitative factors to maximise profit and partner returns.

Releasing cash

Debtor management is the key to releasing extra cash into your business. By reducing the amount of lock-up days by just two weeks in the first scenario, an extra $200,000 in cash would become available – and could be used to fund a new hire or promotion, pay off debt, or as extra partner draws.

So how can you manage debtors more effectively? This comes down to the culture of the firm, and here are some examples of the ways our clients have developed their debt recovery processes.

Summary

We'd like to thank all our round table participants for these open and honest discussions around cashflow issues. It's clear that many are already seeing positive signs of growth, and are putting plans and processes in place to manage that growth for the long-term.

The key is to ensure cash is available to fund the additional resources needed for growth. This may come through better WIP management, an overdraft or business loan, or a combination of both. Planning ahead with your banker can prevent cashflow from becoming a barrier to growth.

Partner insights

Assigning responsibility

"Our Practice Manager is responsible for debtor management, and actively demonstrates to us what it costs to run a practice. The reality is, after 90 days you may only recover 80 per cent of the fees and you've lost interest on that money. It's an opportunity cost."

"We recently appointed a very strong credit controller, and reduced our debtor days from 150 down to about 95. It's had a huge impact on cashflow."

"We have a debtors clerk, and she brings any issues straight to the partners. We are also holding a seminar for all fee-earners about this topic, and setting up a process where every time a new file is opened, an email goes automatically to the client explaining our terms of work and how we follow up."

Cultural change, not just a process change

"It invariably traces back to poor engagement – if a client acts shocked that you expect to be paid within 15 or 30 days, you have a problem."

"Following up with a 'softly softly' phone call has become part of the daily work routine, and it's very effective."

"We don't fund client disbursements of more than $100, we ask for that money upfront and put it into our trust account. It's always a good indication of their willingness to pay our fees later on."

"Our staff get an incentive for every dollar above budget they bill and recover. We don't have a credit team because we believe in personal relationships, and the fee-earner is responsible for discussing invoices with their clients."

"We now have a system in place where we send out reminders. An SMS message at 35 days, a statement halfway through the next month, a letter at 60 days. This has brought down our debtor days by at least 50 per cent."

No pay, no work

"We red flag a file at a certain point, we'll have exposure up to a set amount and then we won't continue to work on that file if it remains unpaid."

"We don't see the idea of 'no pay, no work' as realistic. It needs to be managed well to avoid any liability risk."

"If we're worried about a client going into liquidation, we set up a retainer agreement instead, so we get paid in advance and they don't become debtors."

Ready to grow?

It's important to keep an open mind to new growth opportunities, and be ready to take advantage of them quickly.

Talk with your Macquarie Relationship Manager on a confidential basis about your ideas for growth. Accessing their insights and experience with law firms will help give you the confidence you need to achieve your goals.

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