

# PETER SCOTT CONSULTING

## Briefing Note February 2022

### Are you measuring what matters?

In many law firms I come across, there is too often inaccurate and inadequate information (or no information at all) being generated or available for critical decision making:

- Law firms are not capturing what they need in order to produce the information required for soundly based decision making;
- Even if they capture the necessary information, they are often not adequately analysing and assessing that information; and
- They are not organising and making available analysed and assessed information to those in their firms who need it for decision making.

The challenges now for law firms will not get any less or go away. Firms must meet and overcome those challenges if they wish to gain a competitive advantage over rival firms. Those firms which fail to do so will inevitably decline and fall by the wayside. Measuring, analysing, and assessing information will determine the way law firms respond to such challenges, and is therefore of critical importance.

### Measurement in which areas?

When law firms think about measurement it is usually in the area of **financial management**, and in this Briefing Note I will examine what needs to be measured to more effectively manage cashflow and profitability.

However, measurement to generate information relating to key drivers in **other critical areas** of law firm management is equally necessary, and in future Briefing Notes I will look at each of the following areas.

- **Performance management of a firm's people.**
- **Strategic planning**
- **Client relationship management.**
- **Risk and compliance management.**

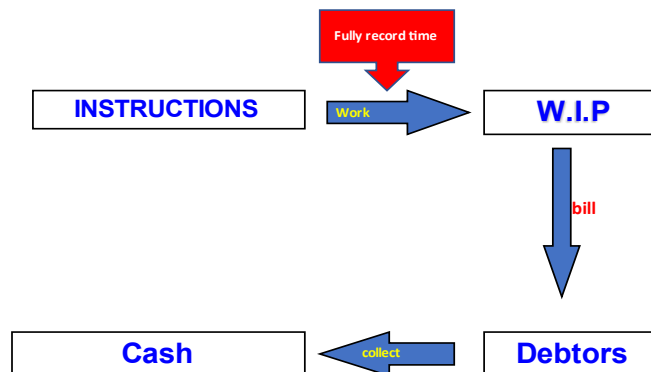
# Financial management

## Cash Generation

Improving cash management through active measurement, reporting and management needs to be prioritised. The benefits of strong cash generation are generally well understood by law firms, and these should act as **prime drivers** of financial measurement to:

- Reduce the working capital required in a firm (lower partner capital required to be invested and / or less bank borrowing);
- Reduce a firm's exposure to risk (bad debts and unbilled / written off work in progress) and provides peace of mind for owners and investors;
- Provide the cash to invest in and develop the business

The cash generation process (and what needs to be measured) can most easily be explained to partners and fee earners by using a flowchart as below.



### Your cash generation measurement?

For example, applying each element of the above flowchart to your firm:

- Do your current 'key performance indicators' (KPIs) tell you what you need to know about your firm's cash generation and your working capital requirement? If not, then a review of your KPIs may be needed.
- Do your KPIs indicate the level of your 'lock up' (the total of WIP, Debtors and disbursements, not yet recovered from clients) and how you can reduce your 'lock up'?

- Do you measure what one day's lock up represents to your firm in financial terms, with a view to planning how to reduce lock up days over a given period of time?
- Do you measure how cash-generating or cash-burning is each part of your firm / each partner /each client?
- Do you prepare regular cash flow projections, and monitor how close you are to achieving your projected cash generation? If not, then you are likely to be *'flying blind'*!
- Do you regularly stress-test your cashflow projections against different scenarios?
- Is your financial measurement providing you with the information required to show you what is happening in the business / what will happen in the business, to enable you to:
  - o make decisions based upon sound knowledge
  - o take effective actions
  - o manage performance
- Is your financial measurement helping you, or hindering you, in achieving your cash generation objectives?

### **Taking Instructions?**

Accelerating cash collection starts at the beginning of the client relationship.

- Do you identify and assess 'client risk' and agree credit limits and 'money on account' accordingly?
- Do you measure (and control) how much cash you pay out as disbursements for clients? (All disbursements should if possible be pre-funded by clients)
- Do you measure how long clients take to pay invoices, compared to the payment terms agreed with clients when taking instructions, with a view to reviewing your payment terms to accelerate cash collection? (Law firms' payment terms have traditionally been 'payment on delivery', which is what I would recommend, otherwise if you give say 30 days credit then clients will take 30 days to pay, and you cannot chase in the meantime).

### **Work / Input?**

Do you measure **in real time** how much client work is being carried out in your firm on a daily basis? **'Input'** is a financial figure based on **daily** measurement of hours recorded on client work X charge out rates X all partners and fee earners. Measuring Input in this way is necessary if a firm wishes to know:

- what is happening in relation to levels of work being carried out in each part of a firm in real time
- what trends can be ascertained from such data, to enable early action to be taken to expeditiously deal with any emerging problems, as well as for future planning for working capital requirements, people resources, office space, etc)

Measuring Input in this way, if it is to be effective, does however require all partners and fee earners to **fully** record and input their matter-related time on a **daily** basis.

### **Work in progress?**

Cash can only be collected from clients if matters have been billed, and so managing WIP by billing matters needs to be **the priority action**. Does your firm's measurement of WIP provide you with the following information, to enable you to maximise your billing:

- Whether partners and fee earners are achieving their 'WIP Targets'? (WIP targets are the **MAXIMUM** amounts of aged WIP allowed to be carried)
- Indicate basis of required billing of aged WIP to meet WIP targets?
- How much WIP will need to be billed [this week] to feed debtors so that cash collection targets can be achieved / cashflow projections validated?
- Indicate which WIP is 'at risk'?
- Show how much of existing aged WIP should be billed **NOW**?
- Indicate levels of WIP write offs both during on-going matters and on billing?

### **Debtors?**

- Do you measure cash collected by partner / fee earner / department against **cash collection targets**? (Cash collection targets should be formulated to **improve** cash collection rather than merely maintain an existing cash collection profile).
- Does your measurement of cash collected have reward / sanctions as consequences?
- Do you measure the effectiveness of your credit control measures?

### **Profitability**

Measurement of what matters is equally as important when looking at the **factors that drive profitability**:

- The type of work a firm does
- The types of clients a firm acts for
- Pricing work – for profit

- Managing work – for profit
- Utilisation (how much available time is spent on client work)
- Fully recording that ‘matter related time’
- Realisation (how much of that recorded time is invoiced to clients and not written off)
- Leverage (whether each group in a firm is organised in a way that uses its people in the most effective and profitable manner)
- Overheads (in particular ‘people costs’ which are usually the single largest overhead)

**Is your firm measuring and analysing each of the above, and what actions do you take as a consequence?**

For example, in relation to building the profitability of the business:

- Do your current KPIs tell you what you need to know about your firm’s profitability and the profitability of each part of the firm / each partner / each client? If not, then a review of your KPIs may be needed.
- Is your measurement of such profitability factors in real time (e.g. daily Input) or historical (e.g. billing)
- At what frequency do you measure of each of the above profitability factors?
- Is your financial measurement providing you with the information required to show you what is happening in the business / what will happen in the business, to enable you to:
  - o make decisions based upon sound knowledge
  - o take effective actions
  - o manage performance
- Is your financial measurement helping you, or hindering you, in achieving your profit objectives?

**Financial measurement of what matters** should be an imperative for all law firms because it creates the relevant knowledge to enable a firm to effectively manage its financial performance.

**When did your firm last review what it measures? And of equal importance, how does it REPORT on what it measures?**

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