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Build stronger cash flow – by actively managing your people's performance

Cash flow cannot be left to chance – it needs to be **actively managed** – and that means improving the financial performance of a firm's people, particularly its partners. How can partners' financial performance be enhanced to enable a firm to manage its cash more effectively?

Change the culture

Improving cash management is one of the most important aspects of how law firms today need to change the ways they work -

Do we know the 'people hurdles' which exist in our firm that will need to be overcome if our firm is to be able to achieve its cash management objectives?

Are all our people prepared to change how they work and behave to help our firm to achieve stronger cash flow?

Do our people all have the skills necessary to help our firm to build stronger cash flow?

The challenge now facing many firms is that even though they can identify the changes that they know need to be made to transform their cash flow, they may not be sure of where to start and may be unclear about the follow up processes they will need to pursue if they are to achieve success. A starting point I would suggest in relation to building stronger cash flow would be to persuade partners ***that the way they currently operate needs to be changed.*** However, which 'levers' will need to be pulled to achieve the necessary recognition by partners that change must happen?

This may be easier to achieve if a cash crisis occurs. There is sometimes nothing more powerful to persuade partners that they must manage their practices differently than the thought of personal bankruptcy or having to contribute additional capital. A managing partner recently told me of his experience a few years ago when his FD had explained to him that unless within six weeks they could collect an additional two million pounds, they would be in breach of their banking covenants. The FD said that as there were fifty equity partners, this would mean each having to contribute a further forty thousand pounds of capital unless they collected the two million pounds. However the firm was carrying plenty of 'fat' in the shape of excess work in progress and debtors and so the managing partner gave his partners an ultimatum – generate an additional two million pounds of cash over the next six weeks or contribute a further forty thousand pounds each. They of course collected the additional two million pounds! The partners were capable of doing what was necessary to better manage the cash but hitherto had never seen the need to do so and no one had ever exerted that kind of pressure on them to do so.

However, being required to contribute additional capital to a firm, or having to retain large current account balances, should not be substitutes to putting in place more effective cash management processes to ensure that a firm operates with no more working capital than is prudently required. ***A more business - oriented 'culture' needs to be built into firms if cash management is to improve***, because unlike a crisis which can force partners to change, just offering 'carrots' to partners to drive stronger cash flow will often achieve very little. If partners can live comfortably on their monthly drawings, then promising to pay them distributions of profits from the previous year or years to reduce their current accounts is unlikely to provide the necessary impetus.

There also needs to be built into firms **an enthusiasm to embrace change** if cash flow is to be maximised. Law firms are 'people businesses' and the success of a law firm will depend upon the attitudes, behaviour and individual performance of the people in the firm being aligned with achieving the firm's objectives. To achieve outstanding financial performance requires a continuous investment in people, services and resources if attitudes are to change and new working practices are to be implemented to re-engineer the way working capital is managed. Innovation is not just about technology – it is more often about the people in the business doing a few simple things better.

For example, whenever I meet with law firms to discuss their cash management, I always ask about the credit terms they agree with clients. The law firm in which I was for many years a partner always provided in its terms and conditions that invoices were payable *on delivery*. I am therefore amazed when I see firms extending a further 30 days credit to clients when they deliver their bills. If you give clients 30 days to pay then they are likely to take 60 days to pay, and of course you cannot chase them for payment within those 30 days. I find however that once firms calculate what providing 30 days credit on invoices can cost them in cash terms, then they very often then change their invoicing policies.

Some firms which have been particularly successful at cash management, have from the outset embarked on major initiatives to raise the awareness of partners and other fee earners of the importance on the part of individuals to follow 'best practice' financial disciplines related to cash management. Firms have launched extensive education programmes in an effort to help partners and fee earners develop a keen culture of financial awareness relating to providing credit to clients and re-educate those in the business as to what is required to maximise cash flow. Education as to ***'why'*** best practice financial disciplines should be followed is often one of the key elements in successfully implementing more effective cash management.

What should people be doing differently?

Management of work in progress and debtors are not disciplines which exist in isolation to everything else happening in a law firm. Above all, the manner in which partners manage work in progress and debtors is very much a reflection of how partners *manage their client relationships*. For example –

- Do your partners as a matter of course ask clients for money on account, or do they think the client will not instruct them if they do so?

- Do your partners agree monthly / interim billing with their clients? If you speak to many clients they say they prefer this because it helps them to plan their own cash flow and to better monitor the relationship with the firm. Partners need to become more business- like and at the outset of a matter overcome their unjustified fear of upsetting a client by daring to suggest a regular billing pattern, and instead be clear as to the credit policies on which the firm operates. Clients are likely to have more respect for a firm which operates in this way.

- Do your partners always agree bills with clients *before* delivering the bills? Bills tend to be paid more quickly if there is already an agreement as to the amount to be paid.

- How much of your partners' existing work in progress can be billed ***now***? The chances are that a great deal of your work in progress is immediately billable but unless there is a crisis, partners do not see the urgency.

- When did each of your partners last *speak* to a client to chase an outstanding bill?

The above examples are touchstones of how partners are managing (or not managing) their client relationships and firms will need to ensure greater focus on clients if they are to build secure financially managed relationships.

Above all, an urgency to bill and collect has to become instilled into the collective mindset of partners.

However, hand in hand with a continuous re-education of partners and other fee earners and the formulation of credit policies to suit the needs of a changing business, there is likely also to be the need for ***sanctions policies*** linked to cash generation targets, to penalise partners through their drawings or profit distributions.

Cash generation targets

Putting in place cash generation targets for each partner or group as part of a cash generation plan can be a particularly successful tool in reducing work in progress and debtor days.
A cash generation plan is not difficult to implement and can involve, for example –

- Developing rolling forward cash-position goals built around a minimum acceptable cash balance at the bank and the cash needed to cover all outgoings for say the next three months (including the cash to pay partners' drawings, and profit distributions in accordance with an agreed profit distribution policy);

- Agreeing realistic work in progress / billing targets by each partner / group based on aged work in progress and planned to keep work in progress within agreed parameters to generate cash to meet future major outgoings;

- Agreeing cash-collection targets by each partner / group, based upon aged debtors. These targets need to be seen by partners to be realistic and achievable;

- Making payments to partners dependent on meeting the agreed cash collection targets. Weekly reports to partners of performance against targets will help to raise real – time awareness of how a firm is performing amongst the partners and payments to partners can be accelerated or delayed depending upon whether targets are met. This can be linked to overall collections or to individual / group collections. In a number of firms a sanctions policy for unpaid debtors which penalises partners through their drawings has been a particularly successful tool in reducing debtor days.

- Firms need to support a cash-generation plan with sufficient resource to ensure that partners are provided with the information and help they need to collect cash and to ensure that the absence of such resource cannot be used as an excuse for inaction.

Changing the attitudes of partners in their approach to billing and cash collection should be a key element of a firm's strategy, enabling it to focus its borrowing capability on projects for the long – term benefit of the practice rather than to meet day to day needs. If successful, growth can be financed without the need to increase borrowing, to make cash calls or to delay distributions to partners.

Effective cash management looked at in this way can be seen to be at the very heart of and essential to a law firm's successful development, and is the reason why changing cultural attitudes and working practices in this regard has become such an urgent necessity.