

COVID-19 and law firms- Avoiding a cash crunch in 2021 when government support ends



Rishi Sunak has brought in very welcome help for business in the current crisis- but this has a sell-by date. But are law firms deferring today's cash crunch until 2021? Has your law firm built a long-term cash flow forecast – and then stress tested the scenarios?

Under the government's proposals to support business, VAT payments due before 30 June 2020 will not now need to be made until 31 March 2021. Self-assessment payments on account due on 31 July 2020 will now not need to be made until 31 January 2021. Further support is available through the Coronavirus Business Interruption Loan Scheme- with 3-6 year facilities, where the government guarantees 80% of the finance to the lender and pays interest and any fees for the first 12 months; the Coronavirus Future Fund match-funding for innovation companies; and other measures such as furlough which will now end on 31st October 2020.

These are very welcome, bold, and necessary initiatives; but they are not open-ended. This could mean financial difficulties for some law firms unless they plan **NOW** to meet the liquidity challenges when the support initiatives end. The cashflow impact may be exacerbated by redundancy payments and partners deciding to step down and wanting capital repaid.

The liquidity of many law firms even in good times is not strong and it only needs a few months of poor billings and cash flow to potentially tip a firm over the edge.

- How many firms with these deferred liabilities are storing up potentially terminal liquidity problems for themselves?

- Alternatively, how many law firm leaders could currently sign off their accounts with a **going concern statement** to cover these deferred liabilities as set out below?

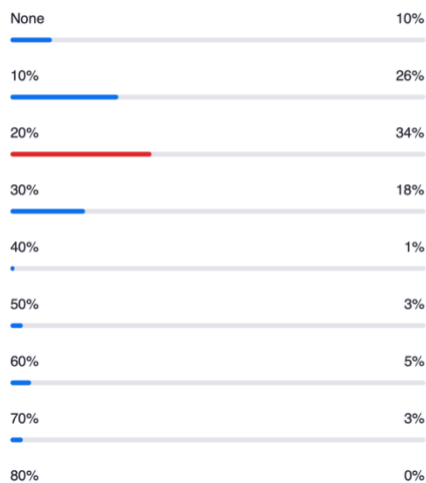
“After making enquiries, the management team has a reasonable expectation that [the LLP] has adequate resources to continue in operational existence for a period of no less than 12 months from the date of signing the financial statements. Accordingly, we continue to adopt the going concern basis in preparing the annual report and financial statements”

- Longer term law firms will need to consider how to provide for a more resilient working capital base than the current ‘hand to mouth’ cash flows experienced by many.

For those with already weak liquidity pre- COVID-19, the deferred liabilities crystallising once government support is taken away will potentially be terminal, unless they plan now how to remain viable and manage through the approaching cash crunch.

Revenue growth will help some firms, but most are cautious. At the Managing Partners’ Forum webinar on 15th May, 52% of firms forecast a 20-30% fall in revenue over next 12 months and 62% expect a 10-30% fall. This will have a major profit and cash flow impact.

8. What level of dip in your firm's income are you predicting over the next 12 months?



We cannot emphasise enough the need to regularly **stress test cash flow forecasts** to obtain as realistic a view of future liquidity as possible, because without it a law firm will be flying blind, and possibly towards failure - see our earlier bulletin on stress testing -

<https://peterscottconsult.co.uk/briefings/COVID-19-StressTesting.pdf> . This will also be requested by the banks for extra facilities needed to take advantage of opportunities.

Another looming challenge for many will be to decide what to do when the furlough scheme finally ends on 31st October 2020 if workloads do not show reasonable prospects of returning to pre-COVID-19 levels. Should law firms consider changing their business model with the inevitable redundancies if they have not already done so (many already have)?

Future manpower and space requirements are likely in turn to depend upon answers being provided to other questions which firms should now ask themselves, including:

- **What kind of firm should we realistically be in the future?**
- **Will we be able to achieve our ambitions on our own / survive on our own or will we need to acquire, merge, or downsize?**

The difficulty is that eventual outcomes for UK law firms as they emerge from COVID-19 may not be completely clear for some time. Effective decision-making depends upon the future being reasonably certain but at the moment certainty is in short supply.

So, what can the leaders of law firms do in this situation?

Some make try to ignore the problems or pretend they will go away (they will not).

Others will understand that a range of options is likely to begin to crystallise for them and so will plan effective strategies to take into account these options and the opportunities they will provide, as well as dealing with any threats that may exist.

This is where **scenario planning** can help a business to effectively plan and execute strategies even in times of uncertainty as now, and indeed scenario planning was developed to do just that. Scenario planning assumes that the future will differ greatly from what we know today, although how different is an unknown factor, and is based on creating a series of different futures from a combination of

- known factors; and
- the impact of possible alternative driving forces such as (in COVID-19 circumstances) *politics, economic conditions and science / technology*

In short, it builds a series of “plausible futures” around which the leadership can plan.

A law firm which wishes to plan for its future post-COVID-19 around possible scenarios should:

1. develop processes to scope its **key issues**, including risks to its business, potential opportunities, and areas where improvements to its business may be required
2. develop **core scenarios** to test its key issues; and
3. understand the potential or probable **impact** of each scenario on its key business areas

Scenario planning will not provide a law firm with all the answers, but it will help it to better plan its future in these highly uncertain times. Law firms which are able to assess the implications for them of COVID-19 rather than opting for inactivity, complacency or lack of knowledge will be the ones able to more quickly grasp the opportunities available, mitigate any risks to their businesses and build their competitive advantage.

As strategic advisors to law firms, we are currently helping to guide clients through their strategic and financial planning as they begin to formulate their plans to emerge in a viable state from COVID-19 circumstances, **and before issues become insurmountable.**

We are also helping to identify potential acquisition and merger targets for law firms which have already concluded that there are either growth opportunities in the legal market, or that they will not be able to either achieve their ambitions on their own or to survive on their own.

If your firm is now beginning to consider its future or you have any other issues, then please call either of us for a preliminary no obligation discussion. We will be pleased to help.