

IMPROVING PROFITABILITY AND CASH FLOW

How can I improve my profits?

In simple terms, profitability can only be improved by three means - increasing revenue, increasing fee earner efficiency and decreasing costs. The keystone of any legal practice should always be a good time recording system. Instilling the discipline of accurate time recording ensures at the very least that all chargeable hours are considered for billing and indicates the actual cost of the assignment. A system that requires instant time recording is preferable as it helps to ensure that all chargeable time is entered. Systems available include daily timesheet entry or using light pens to scan bar code labels on files. Time recording systems are able to produce a variety of management information reports which can be used to improve efficiency and ultimately revenue. Reviewing non chargeable time will indicate areas of poor working practice and inefficient use of time. Where chargeable hours are used as the basis of billing, it will be possible to monitor the recovery rate to ensure that all aspects of the work are being billed to the client. In some areas this may result in increased fees.

It is also important to review areas of the cost base on a regular basis such as energy, office and finance costs to ensure that any possible savings are being made.

How can I monitor profitability?

It is important to set a budget against which to compare your actual results. This should be set on an annual basis and it can sometimes be useful to have a "rolling budget", where the budget is updated for actual figures as the year progresses. The four key elements to consider in the budget are fees, salaries, overheads and working capital. Actual figures should be compared to budget on a monthly basis and any variances investigated immediately. Actual results should be compiled in an easily understood manner and on a timely basis. You should ensure that enough information is given to show up any trends, for example by splitting results out by quarter and showing a full year's results for at least the previous year. You should also consider separate analysis of fee income by work type or by department. This can also be usefully displayed in graph form.

Although I make reasonable levels of profit, I never have enough cash. How do I rectify this?

Profitability does not necessarily translate into cash flow. At any one time cash is tied up in work in progress, unpaid bills and unbilled disbursements. A typical measure of this (excluding disbursements) is the "lock up" period. This is

calculated by dividing outstanding profit costs plus work in progress (at selling price) by a firm's daily average fees. An average figure for 2-4 partner firms is around 120 days (source: LMS Financial Benchmarking Survey 2001). There are basically two ways to reduce this "lock - up" – by ensuring work is billed promptly and by ensuring debtors pay promptly. Where possible, use standing orders and ensure that interim bills are raised. It is also important to get the administration right, so ensure that fee earners give priority to raising bills. It is a good idea to have a pre-set strategy such as raising a bill every two months or when recorded time reaches a pre-determined limit. Once the bill has been delivered, you need to ensure that you are paid promptly. Firstly, ensure that the bill has been agreed with the client before it is delivered, since this will minimise the likelihood of it being contested. Secondly, ensure that payment terms are clear. Also make sure that you submit Legal Aid claims promptly and within the relevant time limits. Consider also payments by instalments, credit card, Switch and standing orders. The other critical area to consider is disbursements. It is all too easy to end up acting as unpaid banker to clients by paying disbursements out on their behalf before the money has been received. Ensure that you make it clear to your client that they are required to pay for disbursements before they are incurred. In civil Legal Aid cases, apply for the disbursement as far in advance as possible. Lastly, make sure that you monitor your cash

flow closely and update your actual bank balance for projected receipts and expenses over the forthcoming period. Review your office ledger listing regularly and ensure that all debtors are chased promptly and monitor work in progress levels closely.

Conclusion

A good time recording system, effective management information and cash flow monitoring is the key to a successful solicitors' practice. We would be pleased to review your current management information systems and cash flow monitoring and advise on any improvements.

Contact Details

Brian Carruthers
Managing Partner
Thomas May & Co
Allen House
Newarke Street
Leicester
LE1 5SG

Tel: 0116 233 5959
Email: briancarruthers@thomasmay.co.uk

Graham Jones
Partner
Thomas May & Co
The Lawns
33 Thorpe Road
Peterborough
PE3 6AD

Tel: 01733 560 212
Email: grahamjones@thomasmay.co.uk

Disclaimer – for information of users

This bulletin is produced for information only and no action should be taken without seeking the appropriate advice. Therefore no responsibility for loss occasioned by any person acting or refraining from action as a result of the material contained in this bulletin can be accepted by the authors or the firm.

December 2004