

A law firm's guide to cash flow in a Covid-19 world



The impact of Covid-19 on cash flow

One of the most acute and urgent issues facing law firms during the Covid-19 crisis is cash flow, with many firms being caught dangerously unprepared.

Law firms have notoriously not maintained cash reserves. If there is leftover cash after paying for salaries and rent, this is typically distributed to the partners. This lean approach to managing cash works when markets are stable, but it has left law firms exposed to the Covid-19 crisis.

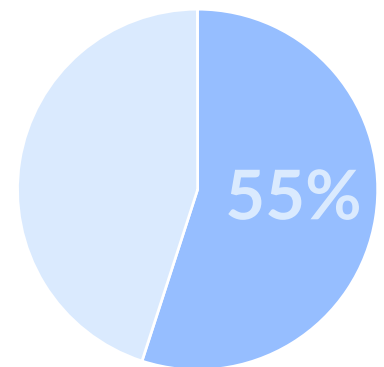
A review by Augusta Ventures of the 2019 financial accounts of 40 leading law firms, with a combined turnover of more than £15 billion, found that **55% of firms did not have enough cash to cover one month's operating expenses** leaving them vulnerable to the crisis.

With delayed client payments and reduced billable activity due to the crisis, law firms across the market are being forced to take immediate action to maintain their cash reserves. These include drawing on credit facilities, cutting partner drawings, requiring additional partner capital contributions and furloughing staff.

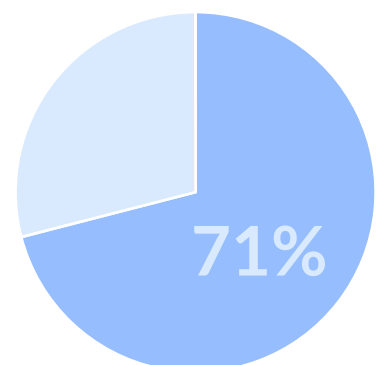
And while these measures may temporarily slow some firms' cash burn rate, the impact on the market will be lasting. The Law Society surveyed 774 high street firms (firms with four or fewer partners) and found that **71% believed they may have to close their doors in the next six months due to the crisis.**

Which is why it is important to consider one of the key underlying issues which has contributed to this perilous position: the need for firms to adopt better financial practices to maintain stronger cash reserves.

In this Guide we take a look at why now is finally the time for firms to tackle lock-up to improve their cash position.



55% of firms did not have enough cash to cover one month's operating expenses



71% of high street firms think they will have to close in next 6 months due to Covid-19

Now is the time for change

Reducing lock-up, the time it takes to convert “work-in-progress” and debtors into cash, is a familiar and enduring topic for law firms.

Professional services firm, Smith & Williamson, found in each of the past 25 years law firms have said they will improve lock-up and yet every year the figures show only a marginal change.

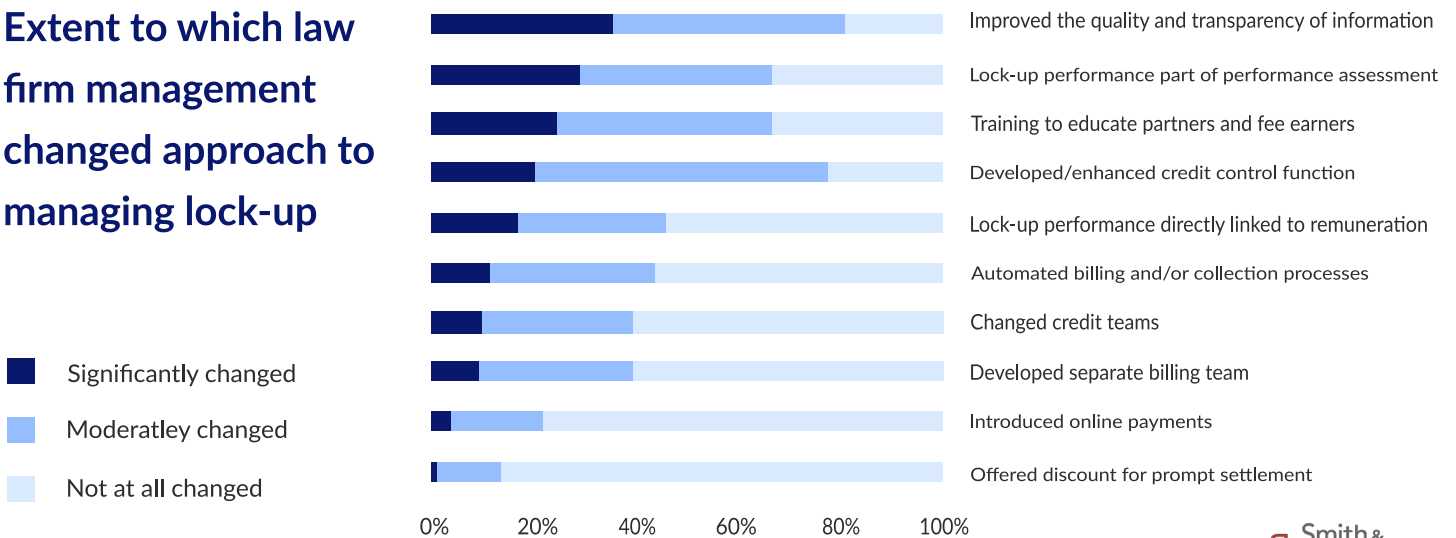
In 2019 Smith & Williamson surveyed 132 managing partners and senior management across the UK and found that **79% thought that their current level of lock-up would improve over the next 12 months**, down from 83% in 2018.

Given **the average lock-up period for the global top-50 law firms is over 100 days**, reducing this figure even by a marginal amount, can have an immediate and positive impact on firms’ cash positions. Not only does reducing lock-up free up cash now, instilling better financial practices means firms will be better prepared for the likely lengthy period of economic uncertainty following the Covid-19 crisis.

100 days

Average lock-up period for the global top-50 law firms

Extent to which law firm management changed approach to managing lock-up



How reducing lock-up will become a key source of cash post Covid-19

Coming out of the Covid-19 crisis, reducing lock-up will be one of the most significant ways to free up cash. Smith & Williamson found that **over one third of law firm senior management said lock-up would be a key source of funding** for their firm in 2019/20. This proportion is likely to increase following the crisis, as other funding sources become increasingly difficult to influence or access.

Giles Murphy, Head of Professional Practices at Smith & Williamson, explains how reducing lock-up frees up cash.

“If a law firm has revenue of £25 million, that equates to roughly £500,000 per week.

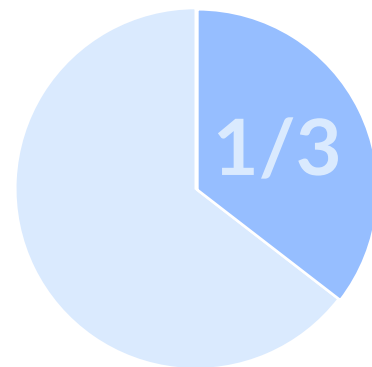
Assuming a steady state, (i.e. firm not growing or declining) then on average the firm will receive £500,000 each week in cash from clients.

If clients stopped paying for two weeks (or on average took two weeks longer to pay) that would equate to two weeks’ worth of cash of £1 million (2 weeks x £500,000).

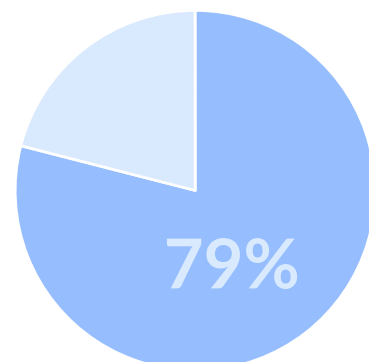
If clients paid on average two weeks faster, the opposite would happen: **the firm would have an extra £1 million on its balance sheet.**”

“ If you are a £25 million turnover law firm and you get clients to pay you on average two weeks quicker, this frees up an extra £1 million on the balance sheet.

Giles Murphy, Partner, Smith & Williamson



1/3rd of senior management considered improved lock-up to be a key source of funding



79% of senior management thought their lock-up would improve over the next 12 months

How to reduce lock-up

Billable activity and profit need to be converted into cash quickly during these uncertain market conditions. As Smith & Williamson found, reducing lock-up requires a combination of a change of culture and investment in the right technology. Here's how law firms can reduce their lock-up period.

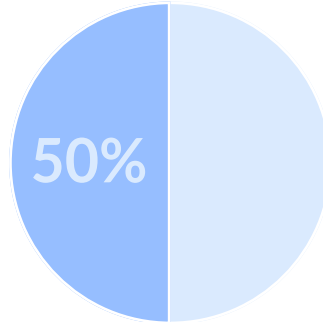
1) Understand your data and set targets

The first step to improving lock-up is to understand your own data, set clear targets and monitor performance. The goal can be simple, for example: the time it takes clients to pay invoices after issuing them. Some technology tools give you access to this data in real-time.

2) Change business practices

While there are some quick wins to be had using technology, ultimately to reduce lock-up you need to change firm culture. Your action plan may include the following:

- **Educate your partners** on the importance of lock-up management in a post Covid-19 world.
- Develop a **new culture around time recording**. Set time recording targets as part of associates' appraisals, and continue to withhold drawings if cash collection is not sufficient.



50% of clients pay invoices out of office hours

- **Improve client communication.** Ensure you are keeping them updated regularly on WIP vs your quote.
- Consider **staggered invoicing**. If a piece of work is going to cost a client £15,000 over six weeks, consider sending three bi-weekly invoices of £5,000.

3 hours

How long it takes invoices to get paid when firms include a link to pay online

3) Use technology

There are now a growing number of technology tools which can help you reduce your lock-up period. These range from lawyer-facing technology, like billing software and time recording, to client-facing technology, like online payment tools.

Legl found that **50% of clients pay their invoice outside of office hours**, and that when firms include a link to pay online with their email invoices, **clients paid on average within 3 hours**.

Before Coronavirus, offering clients the option to pay online meant firms got paid faster, while giving their clients a more frictionless and modern payments experience. **In this new world, having an online payment option is simply a necessity:** it enables firms to operate remotely and maintain cash flow.

What to do next?



If you don't have it, get the answer to "How long on average does it take clients to pay?"



Stagger payments. Issue multiple **smaller invoices** rather than one large one.



Give clients a convenient way to **pay remotely online.**

About the authors



Legl gives law firms the tools to grow and succeed in a digital-first world. From digital client onboarding to better payment options, Legl's easy-to-use software helps law firms give their clients a great experience while modernising manual processes.



Smith and Williamson is a leading firm that has advised over 100 professional practices. They offer a coordinated, cross-discipline approach and provide all-round accounting, tax, business, investment management and financial planning advice tailored to the needs of firms.



Joanna Sidhu
Former Head of Growth at Legl

As a former litigation solicitor at Ashurst, Joanna has experience in High Court litigation with in-house experience at a global investment bank.



Giles Murphy
Head of Professional Practices

Giles advises professional businesses including law firms regulated by the SRA. He has advised on many financial issues including incorporation, funding mergers and acquisitions, and strategic advice.

If you'd like to find out more about how your firm can improve cash flow using Legl's digital tools visit us at legl.com, email info@legl.com or call us on +44 203 951 0165.

If you'd like to find out how Smith and Williamson can help your firm reduce lock-up email Giles Murphy at giles.murphy@smithandwilliamson.com.