Managing Cash, Margins & Profitability: High Impact Changes to Make Now

By Mark Medice on February 19, 2020

Are your lawyers abdicating their responsibility to manage rates, discounts, and cash collection cycles, creating unnecessary leakage and hurting your profit margins?

Saying it differently, are you giving your lawyers the information and guidance they need to make informed decisions about client and matter selection, downstream cash/profit management, and client feedback?

Recent results from the BigHand Global Cash Flow and Profitability Report[1] call out priorities to improve margins and manage cash flow. The report observes many findings, including the following:

- ***Discounting & leakage remain problems.*** While many firms have been raising rates lately, indiscriminate rate discounting is prevalent, write-downs are significant, post-bill collections are more challenging.
- ***Data is underutilized to manage cash and profit issues***. With all the creative discussion in law about predictive data analytics, the survey finds fundamental financial data remains unavailable to both finance (surprisingly) and lawyers in firms.
- ***The visibility of routine profit metrics remains opaque***. Cash management and leakage statistics don't hit the desks of lawyers directly enough. Nor are they reported with enough clarity for lawyers to take appropriate mitigating actions.

The best approach to addressing the challenges above may be a combination of applying traditional profit management principles with today's technology while accounting for the changes coming to the profession. But these projects routinely face resistance and are challenging to do well.

Getting started is critical. Jump-start your firm's steps to higher profitability with high impact ideas presented below.

Cash Leakage Across the Matter Lifecycle

On average, firms in the AmLaw 200 lose 10 percent on discounts, another 10 percent on write-downs, and at least 3 percent on post-bill write-offs. That is a $20B opportunity.

Discounts often occur because of the desire to win the work at all costs, the belief that one must discount in today's market, lack of process, among other reasons. One place to start is by creating a discount floor.

1) Put More Structure in Pricing: Reduce discounts by a meaningful percentage (e.g., 5%) by creating a discount floor. From our research, we find that discounts correspond with partner discounting discretion. Remove the discretion but make exceptions. Maintain discussion with partners about value pricing and its impact on profitability. Encourage similar client discussions. Move the default position to value, not discounts.

2) Create a Leakage Tracker and Intervene Upstream Before the Loss is Too Large: Grade your matters like a stock selector, for example, based on the track record of clients, the performance of your lawyers, and matter characteristics (e.g., work type, fee structure, fee estimate). For new clients, use retainers. And create an action for nonpayment.

Create matter alerts to notify your financial risk team before financials fall too far from budget. Focus on aged WIP as a leading indicator for write-downs. Examine disproportionate spikes in inventory. Pay attention to long-standing idle matters with fee spikes. Close matters timely.

3) Manage Cash Risk with Your Clients with Signals: Classify your clients by risk based on payment histories, industry, and other risk indicators. Create alerts connected to your threshold predictors of bad debt. For example, trigger a warning if a client makes a partial payment on an invoice without justification for a qualified matter.

Data Pragmatics

4) Simplify Your Use of Data: Data is complicated to apply for many reasons. Some causes are technical, but others relate to data availability, trust, and comfort with its application. Many firms have very closed information sharing policies that may need to evolve to support the profit programs described above.

Start simple, using reliable data to build data credibility. You don't need fancy models or AI to start. But recognize the importance of data and get started. Have key respected lawyers play a role in developing the trust and credibility around data. Rely on your allied data professionals to help you through the exercise.

Increased Accountability

5) Improve Accountability by Increasing Visibility and Creating Targets: Many compensation systems should change in the coming years as firms move away from pure revenue-based reward models to those based on strategic profit contribution, and other performance measures. But even if your firm is not ready for a compensation overhaul, you can raise accountability by aligning to performance targets, offering regular reporting and transparency to your progress, and coaching lawyers on improvement areas. We have observed that just the act of creating a reporting process improves performance for many firms.

Summary

The findings from the BigHand Global Cash Flow and Profit Report reinforce the opportunities available to firms as they focus on financial hygiene and profit management. The report highlights the many gaps remaining today while reinforcing the importance of closing them to achieve performance levels required to maintain and grow profitability in the coming years. I hope this blog provides ideas for getting started on these gaps to accelerate your profit progress.

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[1] *Between October and December 2019, BigHand gathered 257 responses globally from senior individuals within law firms of over 100 lawyers. The initial operational questions focused on the main cash flow challenges and were followed up with questions around the visibility of key financial data to understand the correlation between reporting levels and optimizing cash flow. BigHand asked LawVision to comment on the report. Click here for more information about the report.*