Small practice management essentials

By Charles Biscoe

I sincerely hope you find this article boring. After all, it shouldn't tell you anything you don't already apply in your practice.

Photo © Dreamstime.com.

Managing a small law firm isn't difficult from an intellectual perspective. The principles are straightforward and there are plenty of educational aids available if you need them. So why do so many small firms struggle?

The problem is basically a combination of naivety, complacency and, to a lesser extent, a lack of interest. When they hang out their shingle, too many practitioners don't appreciate what they're signing up for. They don't realise that professional competence is only a small part of the equation for success. They don't understand the commercial skills required. Those that do often find it hard to sustain the commitment and perseverance that good business practice demands.

As a result, many small practices are struggling. Financial stress is forcing an increasing number of lawyers to question their vocation. Mental health issues are on the rise and practitioners are feeling the impact on their morale, their self-worth and in their personal lives.

What can be done to improve the lot of the small practitioner?

>>

UNDERSTAND THAT YOU ARE IN BUSINESS!

The key to being profitable is to understand, first and foremost, that you are engaged in a business venture. That business is providing legal services but, fundamentally, it is a commercial operation aimed at generating an acceptable profit in a highly competitive industry.

Great technical skills aren't enough. There are bucket loads of good lawyers around and more coming off the conveyor belt every year. Nor is it enough to relate well to clients and achieve good results. These qualities are important, but success in business depends on how well you employ sound commercial principles.

These principles apply as much to a one-man operation as they do to a top-tier firm. Only the scale and the resources available vary.

NO. 1: HAVE A PLAN

Good businesses don't just happen. They are the result of many factors, but they *always* have a clear idea of what they're about and where they're headed. That's what a business plan is. It's a roadmap which gives your business a clear sense of direction and helps you to stay focused on your ultimate goal.

Business plans are not just for major corporate entities with big budgets. Every legal business, large or small, operates in a complex, changing environment. Business planning is a vital tool in ensuring you can proactively adapt to emerging trends. It brings intellectual rigour to decision-making, establishes a solid framework for day-to-day operations and provides a clear sense of purpose for staff. It is an essential precursor to budgeting and business development activities.

Vision and values

The first step in business planning is to have a clear aim – a strategic level statement articulating the long-term goal of the firm – the vision. Make it an unambiguous statement of the owner's intent. It should provide a strong focus for the practice, it must be credible to staff, and it has to be achievable within the firm's resources.

As a business owner, it is also important to articulate in a few short phrases the qualities most important to you – your values. Values underpin culture. Once you've decided on them, they're there forever.

Situation analysis

To objectively consider the prevailing environment and what might be around the corner, a SWOT[1] analysis is often used. This doesn't have to be complicated. You can do it yourself and you should seek input from your staff.

Analysing your current situation should be straightforward. You ought to be familiar with what's working and what's not. But it's still important to review your financials for unwelcome trends in file flows, revenues or expenses. It can also be useful to complete a benchmarking survey to see how your firm compares in different profitability and expense categories. Other aspects to consider are:

- ***Revenue Contribution.*** Where does your revenue come from (fees/client and fees/work type)? Is your practice sufficiently diversified? Are any clients 'at risk'? How would you cope with losing a major client? How can you guard against this, or limit the downside?
- ***Staffing.*** Always a huge influence. How effective are your fee-earners (budget performance, fees-to-wages ratio)? Do you need to replace poor performers, up-skill others or take on new staff with different skills? How can you improve leverage?
- ***Technology.*** Is your current IT infrastructure adequate? Is it time to automate certain work types to save on production costs? Is a cloud solution worth considering? If so, what's involved and at what cost?
- ***Premises*** Do you have enough space or do you have to think about moving? If so, when, where and what will be the impact on your budget?

Future outlook

A quick review of economic, political and social trends is essential. What's the interest rate outlook? Is the overdraft adequate, or do you need to re-finance to ensure adequate working capital? How are you going to finance disbursements now that most funders such as ASK have left the market?

What effect might government programs such as the proposed National Disability Insurance Scheme have? Could they affect your current practice or open new opportunities?

What is happening to the population demographic in your area? Should you be putting more resources into your elder law practice, say?

What about the explosion in social networking? Should you be using Facebook and Twitter to get your message out?

Sun Tzu said you have to 'know your enemy'. Who are your competitors and what threats or opportunities do they represent? How do you differentiate your firm? Should you be considering an acquisition or merger?

What about your pricing? Do you know your cost of production or do you just charge what you think the market will bear?

What are your personal goals? How hard are you prepared to work and for what return? Can the business support your expectations? How long to retirement? Should you be grooming a successor?

The business strategy and objectives

Having reviewed where you're at and what the future is likely to offer, you can make rational deductions about the areas in which you practice, new expertise you should acquire, the clients you want to attract/retain, staff, technology and other resources, and the level of profitability you can expect.

These deductions are condensed to form your business strategy for the year. Your strategy is an articulation of the broad steps necessary for you to achieve your vision. The strategy is then broken down into discrete objectives (usually four to five) which, collectively, enable the strategy to be realised. While some may be difficult to quantify, each objective should be measurable.

Each objective should be supported by an action plan that spells out the detailed steps in achieving each objective, who is responsible, the resources required and the timeframe.

Writing the plan/distribution

You now have the key elements to write your business plan. For a small firm, the plan would usually be three to five pages. Share it with your staff. Explain the rationale behind the words. The better they understand your thinking, the better they will be placed to transform the plan into reality.

Review process

Once the plan is completed, don't let it gather dust. You need to drive its implementation. Refer to it frequently. Regularly review its assumptions and, if conditions change, adjust your strategy. Monitor progress. If it isn't satisfactory, get things back on track.

Summary

In constructing the plan, don't get hung up on terminology. It's the process that's important. That process will bring intellectual rigour to your practice and provide a meaningful context for the operations of the firm and its staff. Armed with a well-conceived business plan and a regular review process, you will have an enormous advantage over firms which aren't.

NO. 2: MONITOR YOUR FINANCIALS

Just as business-planning provides the intellectual framework, budgeting provides the financial framework for the firm. Budgeting is the first step in monitoring financial performance effectively.

When I say budgeting, I'm referring to two processes. Firstly, the revenue and expense (R&E) budget which is focused on bottom-line profit and which forms the basis of the profit and loss statement (P&L). Secondly, and usually the most important for small firms, is the cash budget or cashflow projection. Both are very important business tools.

R&E budget

The R&E budget considers revenue achievable from existing staff and anticipated clients, and compares it against overheads and new expenses required by the business plan. These measures are balanced to achieve targeted profit.

In constructing the R&E budget, *theoretical* revenue from all fee-earners is considered – a straight calculation of working days/year at a set number of chargeable hours/day/fee-earner.

Historical performance, current work in progress (WIP) balances and expected new business are used to estimate *potential* revenue.

Theoretical and *potential* revenues are then compared and management decides what annual revenue target is set for each fee-earner. These targets combine to form the projected annual revenue.

Overheads are then collated and any new expenditure under the business plan is included.

Once finalised, revenue and expense projections are bought together to produce the projected profit. They are then phased over the year in monthly targets. The annual R&E budget is implemented 1 July.

Fee-earner targets

To make money, you must make a satisfactory return on each fee-earner – usually three to four times salary. The process of comparing *theoretical* and *potential* revenue will tell you whether you are over- or under-staffed for the work available. Monthly billing and time targets should be set for each fee earner to establish their accountability. Progress should be closely monitored.

'Cash is reality, profit is just an opinion'

The R&E budget looks at the profitability of your enterprise. Assuming you are making a profit, the cash budget or cashflow projection will tell you if your business can survive to enjoy it.

In good times, revenue and profit tend to be the focus of >>

business owners. But when things deteriorate, cash is king because cashflow is the lifeblood of a business. Many small law firms experience 'cashflow' problems because they don't understand that income isn't really *income* until it is cash in the bank.

Profit – even if you pay tax on it – is just a book figure. It won't actually pay for anything. For that you need cash. Focusing solely on the P&L can be misleading, because apparently healthy book profits can mask an emerging cashflow crisis. You need to consider *both* profit and cash.

Understand the drivers of cashflow

To get across cashflow, you must understand how cash is absorbed and released by the balance sheet. You must grasp the numbers regarding working capital. Adequate working capital is essential to fund day-to-day operations. The components of working capital which drive cashflow by absorbing and releasing cash are debtors, WIP and creditors.

To manage cashflow, you also need to understand lock up – the time taken to convert a new file into cash received – obviously the quicker the better. To minimise lock up, WIP must be billed regularly and a strict approach to collecting debtors is essential.

It's crucial to keep the gap between the average time it takes you to collect your debtors and the average time it takes you to pay your creditors, as low as possible – the wider the gap, the greater the cash absorption by the balance sheet.

The cashflow projection

The cashflow projection is a crucial diagnostic tool which charts the predicted flow of funds over a period, usually month-by-month, with cash being recorded as it moves in and out. The projection is linked to the bank balance so that the firm's cash position can be anticipated well in advance.

A cashflow projection is only as good as the data in it. The easiest way to get reliable numbers is to use historical data as well as any new income or expenditure required by the business plan. There are computer programs available for charting cashflow, but you can construct the projection using any spreadsheet program.

Once constructed, the cashflow projection should be updated with actual figures so that the accuracy of future predictions is continuously refined.

If your firm enjoys stable and predictable cashflow, quarterly forecasting is sufficient. However, the greater the uncertainty, the shorter the projection required. For the average small firm, this usually means monthly forecasting, but if cash is really tight, weekly projections may be necessary.

Hints for improving your cashflow

- Communicate your trading terms at the initial engagement.
- Bill regularly.
- Implement a credit control policy which increases the pressure on the debtor proportionally to the age of the debt.
- Bank cash promptly.
- Take full advantage of creditor trading terms. Don't pay early.
- 'Smooth out the lumps'. Build cash reserves to cover lean periods – BAS time/Christmas time.
- Plan major purchases and partner draws.
- Avoid ATO/ ASIC penalties by paying on time.
- Pay expenses by credit card to buy time, but pay accounts on time to avoid interest.

Debtor management

Hopefully you've got the message that effective credit control is critical to cashflow. This begins at the engagement where the firm's and the client's expectations need to be established.

Most bad debts result from dissatisfaction with service delivery or pricing. This can be ameliorated by managing client expectations. At the outset, tell clients what the matter is likely to cost and keep them updated when estimates change.

Given the vagaries in estimating costs, it is important not to 'set the firm up for failure'. In your estimates, it's better to err on the 'high' side. If the matter is then completed at a slightly lower cost, a positive perception is created which should lead to quick payment. At the very least, the final bill should be no higher than what the client has been led to expect. If bills don't contain unpleasant surprises, there is unlikely to be an issue in settling them.

The firm's credit policy should be explained during the initial engagement, reiterated in the terms of engagement and acknowledged by the client.

With new clients, an 'up front' payment of fees and disbursements should normally be requested before work commences. It is also important to consider whether a credit check should be conducted before accepting instructions, particularly where the matter is likely to involve substantial fees over a prolonged period. Establishing a credit limit on a new client is recommended where the cost of the matter is difficult to estimate.

As the matter proceeds, if the client fails to pay interim accounts, ceasing work should be considered. You should also consider charging interest on accounts outstanding beyond your trading terms.

In collecting fees, the 30-day point is critical. The most effective way to reduce late payment is to contact the client at that point. This reminder is best framed in terms of a review of the matter with payment raised as part of a general enquiry as to satisfaction with overall service delivery.

All debtors should be reviewed monthly. For accounts outside your trading terms, follow-up action should be determined by your credit control policy. This policy should consist of a regime of phone calls, reminder letters, and letters of demand at specific points such as 30, 45 and 60 days. At the 90-day mark, formal recovery action should be instituted.

Finally, a word on clients who continually cause you grief on the payment front. Ask yourself if you really need the aggro! Politely decline their business.

NO. 3: GET THE MOST OUT OF YOUR PEOPLE

Aside from cashflow, many small firms find that attracting and retaining good staff is their greatest challenge. Be under no illusions. Your staff can have a huge affect on profitability and your reputation, so it's really important to develop a committed, competent and cohesive team.

Why do so many lawyers fail in this regard? Often, it's a failure of leadership.

Leadership is fundamental to getting the most out of people. Most of us are not born leaders, but that doesn't mean we can't learn the essential elements of successful leadership and work to adopt them in our daily dealings. Here are some of them.

Establish the goal posts

Leaders must articulate what they want their staff to achieve. This article has stressed the importance of business planning. Establishing clear goals and communicating them unambiguously is the first step in building a motivated team.

Communicate effectively

Communication is critical. You must tell your staff what you're trying to achieve and keep them briefed on progress. You must provide feedback about their performance. But communication isn't a one way street – seek your people's opinions. You might not always be swayed, but giving staff the opportunity to contribute is vital to team-building.

Don't assume you know it all. In many operational issues, your staff will be more expert than you. Learn to listen – it's surprising what they can teach you. Encourage and reward innovation.

What's happening in someone's personal life has a huge impact on their professional performance. Use effective communication techniques to connect with your staff as individuals, not just numbers. When staff realise you are interested in them as individuals, they will connect with you on a personal level and be motivated to help you succeed.

The easiest way to build rapport is to get out of your office regularly, walk around and talk to your staff. A word of caution – always be absolutely sincere. Insincerity is death in building personal relationships. Your staff will sniff it out a mile away.

Walk the talk

This is vital. If you expect certain behaviour around the office, don't expect to get it if you don't practise what you preach. Your personal behaviour sets the standard for your staff.

Stay calm under pressure

Good leaders don't shout when the pressure is on. They don't turn on their staff and they certainly don't lose the plot. These things can destroy your leadership. In times of stress, people look to their leaders for guidance and reassurance. They expect their leaders to shoulder their responsibility, to act with perspective and to deal calmly with adversity.

Delegate

Trying to do it all yourself is a recipe for trouble. You must delegate, not only to get work done in a timely fashion but also to deliver on your responsibility to develop your staff. At all costs, avoid micromanaging work that has been delegated. Put good systems in place and trust in them. Effective delegation should give you more free time to think strategically or to improve your golf.

Make a decision

Timely decision-making is a crucial part of leadership. By all means, be considered in your decision-making. But your people expect you to have sound judgement. They need decisions in a timely manner to give them clarity in executing their responsibilities.

They mightn't always like your decisions, but they will respect them if they are explained and implemented consistently. Dithering and procrastination destroy confidence in your leadership. Learn to trust your judgement and intuition.

Firm but fair

Don't expect your staff to love you. You want them to respect you. Too many leaders accept sub-standard performance because they fear staff reaction. In the military, there is an old saying for leaders: 'Start strong – ease back'. It's much easier to insist on adherence to high standards from the outset than it is to try to impose them later on.

IN SUMMARY

To be successful, many small law firms need a change in mindset. The focus has to be as much on sound business practice as it is on good legal work. Profitability can be increased through a combination of analysis and planning, good financial practice and personal leadership.

Implementing the disciplines described in this article takes commitment and energy. But the potential reward is higher profitability, less stress and increased personal satisfaction. What's not to like about that?

Note: **1** Strengths, Weaknesses, Threats and Opportunities.

Prior to becoming involved in the legal industry, Charles Biscoe enjoyed a long career in the Navy, where he served in a variety of command and high-level operational posts both locally and overseas. He has extensive experience in managing legal practices and currently consults in this area, focusing on smaller firms. In addition to assisting private practices, he has run programs for both the Law Society of NSW and LawCover. Charles is also a nationally accredited mediator and conflict coach with considerable experience in settling both commercial and workplace disputes.

PHONE *0418 408 858.* **EMAIL** *Biscoe@bigpond.net.au.*