

Re-shaping your firm – and how to pay for it

Chris Marston, Head of professional Practices at Lloyds TSB Commercial, takes a look at how solicitors firms can compete against external capital.

The SRA is now at last able to licence Alternative Business Structures. New players will enter the market before long. So how can traditional firms survive or even thrive in the new competitive environment?

Building on solid foundations

From the outside, law firms are perceived as traditional, conservative, reliable and solid - like a building. Perhaps a slightly quirky building, but a solid edifice nonetheless. Somewhere the three little piggies could feel safe. That's what clients want - reliability. As someone who sees law firms from the inside, I'm often struck by the lack of foundations from a financial perspective. Imagine your firm's balance sheet as if it's a building. That bit at the bottom - the capital you as owners have invested in it – holds up the rest of the balance sheet and in too many cases is insufficient for the purpose. It's like having a house on stilts.

In other areas of business we'd call this overtrading, but in the solicitors profession we've got used to it over the years. Many of our solicitor customers are under-capitalised. We understand the reasons. Even those businesses that converted to LLP or limited company status still have balance sheets influenced by their previous partnership status, and the traditional partnership offers no incentive to retain profits and build capital. It's bad for tax and bad for succession planning. Because of this, partners have tended to draw profits fully and keep their wealth outside the business.

This restricts growth and encourages a lifestyle attitude to business. This is a perfectly reasonable choice to make, but it will put firms at a disadvantage against new competitors who will invest profits in growing capacity and efficiency. Some new thinking is needed here about remaining competitive, but also facilitating exit planning. A buyer wants to see value in the balance sheet.

A strategy that everyone's signed up to

A solicitor friend described being in a professional partnership as being married to five people who he didn't like very much. That may be exaggerating a little, but there is little doubt that in many firms there are competing priorities, preferences and prejudices. The firm's goals are not always clear - largely because they aren't considered and discussed often enough, and personal goals aren't always congruent with those of the business. I've seen real unhappiness and stress among partners when difficult conversations are put off. It can be painful, but I've observed at first hand the benefits

of flushing out conflicting ambitions and getting everyone on the same bus. This may involve giving some the opportunity to get off, sometimes because they reached their destination years ago.

It goes further than the owners of the business, too. Ensuring that all staff know what the firm is trying to achieve is important, and motivating them towards playing their part in the firm's mission is critical. Performance management systems that recognise and reward the right behaviours in this respect, combined with regular communication and provision for feedback will over time embed a united culture.

Embracing IT

It's been said that we only use a small percentage of the capability of the human brain, and this is also probably true of practice management systems. Effective use of IT can reduce costs and help to generate income. The possibilities are endless, the number of suppliers growing, and costs are now within the reach of smaller firms. Good IT can help with: -

- Financial management, producing high quality and timely MI to help business owners identify trends and manage the business effectively
- Performance management, using a wide range of performance data – not just hours billed and recovery rates. This allows the right behaviours to be rewarded
- Online document preparation, reducing costs and outsourcing work to the client!
- Case management systems
- CRM systems, allowing a focused approach to active client relationship management, more instructions and greater client satisfaction

It's far from certain which new externally-backed competitors will be active a year from now, but you can be sure they'll have the very best IT, and use it fully.

A client-centred approach

Satisfied clients will use you again and recommend you to others. Too many firms seem content to deal with clients' needs on a transactional basis and solely on their own terms. More enlightened firms will consider imaginative pricing structures and payment options, use fact-finding techniques at the start of each matter to get a deeper understanding of the client and his/her future needs and use that information to unlock future opportunities.

Being easy to deal with and flexible in approach hasn't always been solicitors' best suit. And talking of suits, there's a whole raft of potential clients who are put off by what they perceive as the stuffiness or even arrogance of solicitors. Many (even hard-headed SME owners) are actually intimidated by solicitors, seeing them as people with big brains who are going to make them feel uncomfortable and inadequate. And they almost always think you're going to be far more expensive than you actually are.

Showing clients that you care, that you value having them as clients and that you're human (big brain notwithstanding) makes quite an impression. Loyalty cards (perhaps with a 'regular client discount') can keep your brand visible to clients and their immediate circle.

Your staff can be a fantastic asset in this exercise - they probably are much less intimidating to clients, they may be more at ease with the idea of selling, and if they enjoy being in your firm, they'll almost certainly be more than happy to tell their friends and family about the great service your firm can give.

There's nothing wrong with selling

Two years ago I gave a series of talks for the Law Society at a number of regional locations with the theme of surviving the recession and 'managing your bank manager'. Whenever I mentioned selling the disapproval in the room was palpable. I think things have moved on since then, but even so I still detect a discomfort with the sales culture. Firms must accept that everyone has a sales role. The firm exists in order to generate income, pay salaries and wages, make a profit and reinvest for the future.

Of course we've all experienced bad selling techniques, whether it's unwanted telephone calls, spam emails, junk mail, pyramid selling and so on. We don't like it. However, we've also seen excellent sales operations at work, but we don't tend to recognise that as selling at all. Do the staff at John Lewis operate in a sales culture? You bet they do. And at the Co-operative too, where Funeralcare staff are being trained to refer business to their Legal Services colleagues. Will their clients feel that they've been 'sold to'? It's much more likely they'll feel that a problem has been taken away from them.

Take advice

Whether you're a sole practitioner, or a finance partner or managing partner in a firm, it can be a lonely job. In businesses that often feature a parity ownership structure it can be hard to get clarity of vision and commitment to action.

Where can you turn for help? How willing are you to listen to ideas from outside? I'd suggest there are a few sources of quality advice worth exploring, and I'll mention a few here.

- Your accountants should be in a strong position to help you, particularly if they are members of the Institute of Chartered Accountants' Solicitors Group. This member body of the ICAEW comprises accountants who specialise in advising solicitors as clients and its members have used their specialist knowledge to achieve excellent outcomes for solicitors such as campaigning with the Accounting Standards Board to secure the proper treatment of WIP on contingency fee work and thereby avoid paying tax on profits and cash that have not been (and may never be) received. As professionals, they understand your non-corporate view of the world, client confidentiality and professional standards. They can help you with financial management and, crucially, financial forecasting.

- Member groups can provide help, support, best practice and buying power. The various franchise-style operations such as Quality Solicitors, Lawyers2You, High Street Lawyer.com, and Face2Face Solicitors have been much in the news lately, and their business models may or may not be attractive for your firm. But there are other groups, suitable for firms of different sizes and types that can offer real benefits. Examples include 360 Legal Group, LawNet, The Bold Group and Connect 2Law.
- The Law Society's Law Management Section is an excellent forum for those engaged in the management and leadership of law firms, offering conferences, workshops, seminars and research material that help members to manage their firms more effectively. The LMS Annual Financial Benchmarking Survey is the most in-depth analysis of law firm performance in the market.
- Bank managers can help. They understand what makes businesses tick, and some banks have invested in sector training. At Lloyds TSB Commercial we have more than 100 specialists trained as Lexcel Consultants and committed to 20 hours of CPD per annum to retain their specialist status.
- Some firms are recruiting non-executive directors. Someone who is successful in an unrelated business will see things differently and offer a refreshing and alternative point of view. You may have a client who could do this.

Financing the firm

There's no such thing as free money, but, as I'll show below, you can get pretty close to it. Let's take a look at the main sources of finance for a law firm.

1. **Equity.** This is what ABS will permit. It's the most expensive form of finance available, because it dilutes ownership and control. Investors want a clear exit plan, and expect to at least double their investment within 3 to 4 years. Independence - something much valued by solicitors, disappears, and full disclosure and transparency regarding finances is required. However, external capital can facilitate much faster growth, and brings a corporate approach to business.
2. **Debt.** Borrowing money from a bank is much cheaper, though there are interest and administrative costs involved. Information disclosure is limited and the dialogue with a lender less rigorous than an equity investor would require. Debt has to be repaid at some point, and security may be required by the lender. Unlike the equity investor, the lender has no opportunity to benefit from the success of the business. On the positive side, firms retain their independence, benefit from flexible financing and borrowing money has never been cheaper.
3. **Owner capital.** Even cheaper than money borrowed from the bank, but there's still an opportunity cost - what else might you have done with that money? There's no 'red tape', it demonstrates real commitment on the part of the owners and there's no need for any external interference. But it could concentrate too much of the owners' wealth in one place, and they need to balance inputs and rewards.
4. **Clients.** No, I don't mean raiding the client account! I'm referring to managing lock-up effectively. Many firms invest far too much in their clients, whether it's billing too

slowly, poor credit control, or paying disbursements without cash up-front. I've seen firms greatly reduce or even eliminate their overdraft by making a concentrated effort in this area. Why not bill every day instead of only at the month-end? How about reducing the payment terms to seven days instead of thirty? My guess is that, like me, you tend to respond to emails instantly. Have you tried emailing your invoices? A well-managed lock-up can liberate free money to help develop and grow your practice.

At Lloyds TSB Commercial our lending to the solicitors profession has grown more than 12% over the past twelve months.* Our credit policy and appetite to lend are positive. But we do expect firms to come to us with proposals that show the right balance between the various forms of finance, and to offer plans that are backed up by good MI and open dialogue. Bankers don't like surprises.

* November 2011 vs. November 2010

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