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10 Best Practices for Enhancing Your Law Firm's Cash Flow

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Think faucet, not ocean. When you think about your law firm's cash flow, it shouldn't ebb and flow like the tide. It should be a constant, steady stream.

But if your law firm is like many others, you may have been struggling to ensure your cash flow stays consistent — especially in the aftermath of the pandemic. This can really hurt your firm's bottom line.

Most small law firms and midsize law firms have past due accounts, which can kill your cash flow and make it possible to pay your employees and bills. And it's often uncomfortable to ask your clients for money!

Some practice areas may be doing better than others. But no matter the current state of your law practice's financial health, you'll always find that there are opportunities to reduce costs, improve lawyer productivity, and get more cash in the door.

How can I improve my law firm's cash flow management?

If you're struggling to keep your firm's cash flow consistent, here are 10 steps that you can take to improve your law firm's current cash flow.

1. Assess your law firm's financial health.

If you haven't yet taken the time to do a deep dive into the status of your law firm's finances, start there. One place to start is by projecting your firm's cash flow by month, quarter, and year.

Begin by understanding your fixed expenses, such as your rent and utilities. Then add in fluctuating costs such as payroll. Consider whether there are any opportunities to reduce your costs by negotiating with your service providers, such as your phone or internet companies, or to set up a fixed payment structure for your utilities so you can better predict your expenses.

Once you've pinned down your costs, it's time to estimate how much client revenue you expect to receive. This will give you a sense of whether you've got a negative or positive cash flow.

2. Establish a cash flow forecast.

Once you get a handle on your law firm's current finances, you'll be able to create an accurate cash flow forecast. And with the right practice management software, you'll be able to quickly generate billing and accounting reports so you can understand your incoming receivables, study where you're making and losing money, and compare your firm's cash flow over time.

3. Make it easier for lawyers to bill their time.

When legal professionals are busy and stressed, they're less likely to focus on keeping accurate accounts of where they spend all of their billable hours. If the lawyers in your firm aren't keeping up to date with the hours they bill, you're likely suffering from billing leakage. They may be losing up to 30% of their billable time!

This is especially true if you're working on fixed-fee projects. It's all too easy for projects to creep in scope and for lawyers to provide work that they don't charge their clients for. To make it easier for your lawyers to capture every billable minute, implement technology that automatically captures their time throughout the day for calls, texts, emails, appointments, and more.

4. Make it easier for clients to pay you.

If you're struggling to get your clients to pay on time, it may be because there's friction in your payment processes. Set up a system that accepts different payment options, including online payments, to streamline your invoicing and collection processes. If you aren't already sending your clients bills by email, now is the time to start.

Typically, accepting credit cards will expedite your payment cycle and make it easier to track incoming cash. It may be worth paying a small convenience fee to a processor to get payments in the door more quickly.

5. Unlock cash that's locked up in your firm.

Speeding up payment requires firms to lower the time between completion of work and billing. Make sure your lawyers are invoicing for their billable hours as soon as possible — either when work is completed or at a reasonable point in the interim.

If your attorneys take too long to review their bills, send them reminders and set a policy that bills must be reviewed within a set number of days. Clients don't like it when they receive bills months after work is completed. And it's often helpful for clients to receive a bill at the beginning of the month, which is often right after their payday.

You may also entice clients to pay faster if you offer a discount for earlier payment, such as within 15 or 30 days of your invoice. Typical discounts are between 3 and 5 percent of the bill.

6. Follow up with clients about unpaid invoices.

The longer an invoice remains open, the less likely it is to be paid, so review your accounts receivable regularly and set a cadence for following up.

It can be uncomfortable to ask clients for payments. But it's necessary to have these conversations and offer your clients a solution, if necessary. Instead of asking clients when they can pay you and how much, it's often more effective to present payment plans to your clients. Consider proposing a 60-day plan with installment payments, which may make the overdue amount more palatable. Another effective strategy is offering clients a brief email reminder with a link to pay online.

Because lawyers in your firm may worry about jeopardizing client relationships, it may make sense to have a billing or accounting professional manage the collections process; you may also want to consider outsourcing collections to a third-party provider.

7. Avoid surprises on your bills.

If your client retainers are running low, increase them before you run out to avoid shelling out cash that won't be replenished immediately.

You should also avoid surprising clients with billing for items they don't expect. Make sure your agreements spell out upfront what new clients should anticipate. If you have an unexpected expense or if you have a large bill, prepare the client with a short call to make sure they fully understand the cost before they get your invoice. This way, you're more likely to avoid the need for write-offs.

8. Pay your firm's bills on time.

Make sure that you are paying your bills when they're due. If you pay them after their due dates, you're likely exposing your firm to late fees. And if you pay too early, you're tying up cash that you could use for other purposes.

9. Set aside a cash reserve.

You should have enough cash saved up to cover all of your law firm's expenses in case of a rainy day (or, say, a global pandemic). Use your cash flow analysis to predict your expenses and set aside an amount sufficient to pay your firm's bills for three months. That way, you won't have to panic in case you experience a seasonal slump or another temporary downturn.

Some law firms also establish a line of credit to ensure they have an additional financial cushion in the event of a shortfall. If you don't use it, you won't incur any interest, and it will be there for you when, and if, your firm needs it.

10. Establish metrics that enable you to measure your cash flow.

Setting reasonable key performance indicators will help you keep your firm on the right path. For example, you might track the number of days that bills remain outstanding and measure whether that number drops over time. Or you might study the change in your working capital over time, which is a ratio of your current assets divided by your current liabilities.

You can also account for variances that may account for any changes in your forecasts. The possibilities are almost limitless, especially if you have access to reporting features in your billing or practice management platform.

How can technology improve my law firm's cash flow?

The most successful law firms integrate their accounting processes with a cloud-based practice management software platform that helps them improve their firm's efficiency, productivity, and profitability.

When your firm chooses the right technology, you help your timekeepers eliminate countless minutes that they would otherwise spend on administrative tasks — including timekeeping, invoicing, and collecting on overdue invoices — that take away from your revenue. And you can more accurately (and quickly) project your firm’s finances and study your historical and projected cash flow so you can plan more accurately and set realistic goals for the months and years to come.

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