Focus on Prevention, Not Collections

Many firms spend a lot of time trying to collect bad debts instead of preventing them in the first place. You can change that with a good file opening system, with your Managing Partner approving all new clients and files over a certain size.

Why do this? Because many law firms' compensation systems reward partners for volume of billings or hours generated, not quality of billings or hours. Even firms that reward partners for cash received instead of billings still have to deal with long delays in receiving cash for work billed. The best way to avoid this is to deal with the problem right at file opening.

You need to give the Managing Partner the authority to say no when a new client presents a high credit risk. The Managing Partner is not infallible so you also need to build a simple methodology up front to allow partners to take on new clients on a short leash. This is especially important if they've taken on too many flyers in the past and the firm has worn the results.

A credit limit system is the other half of the prevention solution. Combined with a good file opening approval system, the credit limit system works just like Sears or Macy's in approving your new credit card. You get a credit check done for all new clients and assess the clients' credit history. You then set a total credit limit for the new client which includes total WIP and A/R. The client is informed of the credit limit system in the initial engagement letter. If the value of total WIP and A/R for the client goes over the set limit, lawyers cannot record any more time for the client and the client is told that work has stopped on their file until they have paid their outstanding bills.

Simple, right? Okay, in practice it takes a bit more time to get all partners on board, but once they see the results, they toe the line gladly. Especially when the reward is more money in their pocket. If you can reduce the firm's total investment in WIP and A/R from five months to four months using this system, you've just reduced each partner's share of required capital by one month's billings - a significant sum. And that money stays in partners' pockets as long as they keep the firm's total investment in WIP and A/R down at four months. So partners are incentivized to cooperate with the system and do what they can to help prevent future bad debts. This naturally leads to a significant improvement in the quality of the firm's clients over time. And that's the real reward, since that leads to many more benefits for the firm and its partners in the long run.

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