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DAILY REPORT

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Collections: Sooner is better

ACCOUNTS PAID ON TIME also are most profitable, so don't relegate receivables to low-level task

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On average, American law firms receive payment 120 days after they send bills, but firms could make 27% more by collecting in 30 days. Firms that accept payment four months after billing typically collect just 73% of the total amount due. If they collect in the first month, they receive more than 98% of the amount billed, according to the Commercial Law League of America.

Firms can significantly increase revenue by recognizing the need for strategic leadership in their accounts receivable activities. Accounts receivable are frequently considered clerical work, but managing them effectively requires commitment from the top of the firm and attention to the four A's of collections:

- Anticipate
- Align
- Add value
- Accelerate cash flow

Anticipate

Start by taking an honest look at the firm's receivables and anticipate how much can actually be collected. One client had invoices that were several years old. Many of the companies had only randomly been contacted, yet the firm considered all of the bills still collectable. On investigation, we found that more than half of the companies had declared bankruptcy or been sold. As a result, much of what was on the books was actually worthless.

To reasonably anticipate the true value of accounts receivable, assume that less than 50% will turn into cash after six months and only a quarter will be good after a year. Beyond 12 months, collecting on an invoice is sheer luck.

Validating the books goes beyond discounting for the age of the invoice; look at the specifics of the client as well. In 2009, the key factor in payment of an invoice by a client in the real estate industry was not its age, it was the financial condition of the client. When an industry hits hard times, keeping on top of invoices becomes a priority. Chances are good that some bills are not going to be paid as a company's financials deteriorate and credit lines close, so frequently only those that collect quickly collect at all.

Sometimes the signs of trouble in an industry are more subtle or more local. Law firms can stay on top of these by looking for clusters of slow pays or no payment among their receivables. Perhaps one large company's financial troubles have depressed related local businesses or a new city ordinance has negatively affected a sector.

Align

People often associate 'receivables' and 'collections' with bad debt. In fact, good receivable practices help lawyers get paid faster and reduce bad debt. It's really about taking the right steps up front—billing timely, following up professionally and consistently, and aligning client expectations with the accounts receivable process.

Lawyers often think that they should contact a client about a receivable only when it is past due. For the best results, they should begin the follow up while the bill and the work it represents are still current.

The entire mindset changes when you are discussing a current invoice as opposed to an aged invoice. When discussing a current one, it is a creative, positive mindset. Clients know what project accomplished or problem solved the invoice represents. The value is clear.

When people call about an aged invoice, on the other hand, they have a problem to solve—was the invoice lost, is the client having cash flow problems, will they contest the amount owed? Calling on an old bill is like invoicing them again. The client needs to look at or for the bill and the lawyer needs to remind them why they owe the money. That conversation increases the likelihood that the client will ask for a discount because the value of the work has faded or that the lawyer will offer to negotiate just to get the invoice off the aging report.

Initiating a receivables program is all about changing expectations, as an experience with one organization's client clearly revealed. When she was called for the first time as part of the new receivables process, she said, "I don't understand. Why are you calling me? I pay when I'm ready to pay and that has been fine in the past." She was simply responding to the expectations previously established. Once firms start calling regularly about their current invoices, they often double their collections.

As important, when clients do pay on past due balances or stay current, call and thank them. Thank you goes a long way to building relationships that keep the money flowing.

The engagement letter provides the best opportunity to establish payment expectations. Avoid misunderstandings and set the tone for the relationship by spelling out the billing schedule and expected payment terms up front. The first call on an invoice can then reference and validate the engagement letter as a gentle reminder for timely payment.

Add value

A professional approach to accounts receivable can benefit both the firm and its clients. Regular calls from anyone associated with the firm keeps the firm top of mind with clients, increasing the likelihood of a call about additional work. Depending on the size of the client and the type of law, the client may mention potential engagement opportunities in the course of a call about an invoice.

In addition, regular calls go a long way toward building a good relationship with a client. This may seem counterintuitive, but the calls remind clients who you are and what you do. If the calls are made by a professional other than the lawyer who billed the work, it can also reveal potential trouble in a client relationship. A client may say that they will pay the bill, but that they were unhappy with the lawyer who do it or with the quality or timeliness of the work. While such comments sometimes mask client embarrassment over a delayed payment, often they have more than a grain of truth—and knowing that there is a problem can enable the firm to address it before the client goes elsewhere.

One often overlooked way a well structured accounts receivable process adds value comes from the "Macy's effect." When my mother paid off her Macy's card, she would often return there for her next purchase. She wanted to avoid running up a bill somewhere she already owed money and felt better going to a store where she was not carrying a balance. Many clients are like my mother and prefer to give work to firms to which they do not owe money. Make it easy for them—keep the invoices current so they can call you without worry.

Accelerate cash flow

So many firms focus on cost-cutting to improve margins, but improving their collections often has a bigger impact on the bottom line. One client previously started their collection process when invoices reach 90 days and regularly wrote off $2 million a year or 7.5% of revenue. When they instituted an accounts receivable process that initiated calls at 30 days, write offs dropped 90%.

Even firms that collect most of their invoices in 30 days can see substantial improvements in cash flow with a consistent, professional process in place. Another client went from collecting 87% of their invoices in 30 days to 95% in the same time frame and brought in $250,000 more in a year as a result. They didn't do more work; they simply got paid for more of what they did.

Improving collections has a ripple effect within a firm, too. Once billers know that sending invoices actually increases cash flow, they become more conscientious about recording time and billing promptly. That also brings money in more quickly and contributes to a higher overall collection rate.

Managing receivables needs to be a daily process for all firms and part of the firm's strategy from the beginning. Firms that anticipate problems, align expectations, and add value quickly accelerate cash flow. As important, clients appreciate the consistency and the contact. We find that once firms start following up regularly, clients come to expect it. Some of our clients have been astonished to find that as a result of their new accounts receivable process, their clients sometimes call them to ask whether they owe money.

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