

# Funding growth for profitability

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*After doing the best to represent and succeed for your clients in their varied matters, your next priority should be that of practice funding and working towards a return in your businesses commensurate with the commitment, both financial and emotional that you put in. Too often, legal practitioners skip around the issues of well structured practice financing as "something that I'll get to when I have time" or "all financiers are the same so why bother to change from what I have got" These can be expensive and damaging mistakes.*

All of our businesses need capital resources. As much as the correct combination of staff resources is critical to the success of your practice, so too is the correct structure of short and long term financing critical to the wealth of the principal. Such financing issues must complement the size and nature of the practice as principals will only reap benefits if all the components are aligned together to achieve a common goal.

With this in mind, a few thoughts about funding a plaintiff practice from a banker's point of view may be of interest:

## **The practice is the engine room not the car**

It is human nature for us to become engrossed in our daily activities, to perform as best we can for ourselves and our clients. It is also human nature to get caught up in the immediacy of issues and lose the clarity of the big picture. How much better are we towards the end of a holiday in making decisions that effect our future than before going on one? Recognise that the practice is the power to achieve your goals, but not the goal itself. It is correct that a long term plan of wealth is considered and regularly updated and agreed with your bankers - to treat them as merely a supply of funds for you to do with as you please will meet with the response than the banking system is now often criticised for. The banking relationship is a two way street which you have to

contribute to in a number of ways.

Each principal wants to generate as much wealth from their practice as possible. Further, they need to ensure that the wealth once created is diversified into asset and income classes away from the practice. Working with a single banking institution is more likely to achieve this than a disparate group of financiers. The practice provides to the principal a cash-flow which is to be used efficiently to convert into alternative asset classes (property, shares, bonds, other investments) and income streams (rentals, dividends, capital gains). A single financier who is aware and party to all of an individual's cash-flows can add significantly to this process, particularly in comparison to having number of purely transactional and disjointed bankers.

**Manage your practice (and if you can't get someone else who can !!)**

Too often we see practices that are not

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reaching their full potential as they are not properly managed. The role of Practice Manager (whoever fills it) is vital to its success. This is far from the function to ensure that the bills are paid and the staff and suppliers are content; it is an enormously important role to take the mantle of business decision making away from the legal practitioners (who are better placed concentrating on their files). A principal of a practice may elect to take on this role but should only do so in the knowledge that they have the capacity to complete the task, that it will effect their ability to generate income on files, and that a different skill set is required to be successful. We, as bankers, assess this function in any firm to which we are talking, and we must be satisfied that the practice is managed well before we properly consider any other issue such as security etc.

#### **Borrowing for growth - it is not a security issue**

Macquarie Bank first looked closely at the plaintiff law profession in 1994. It had the hallmarks of a market that has many of the criteria that we seek: it is strongly value added, growth was expected, and there is a clear funding requirement. The large work in progress (WIP) assets that are created, together with typically small and short debtor positions provide unique requirements. As firms grow to a stable and optimum size, there is a need for increased borrowings as staff continue to be paid and rent and other ongoing obligations are met.

We do, however, notice great differences in the manner in which WIP is managed and we often correlate this to the returns of the principals. Although WIP sits on the balance sheet of a practice as an asset, it only has value if it can be turned into a debtor and ultimately converted to cash. Many financiers do not take WIP into account as they are not prepared to understand the elements in differentiating good from poor management of this asset. Similarly, practitioners should display to a financier a thorough understanding of how this works and disclose the risk associated with it. Each practice is unique in this regard and we as bankers need to understand the process of creation of this asset within a particular firm.

WIP is far from a line item on a bal-

ance sheet - it is created from the day a fee letter is signed and concludes when the fees are paid into the account at the bank. For a bank to be comfortable lending for such growth (and there are few that do), you must display that it is managed, it is prudently recorded, that you are prepared to share the funding of its growth with the bank and that the monies are collectable. Everyone is aware that there is a contingent nature to your practices, but the banker (and you as principal) needs to evidence what this risk is, how it is contained, what factors can effect the amount and timing of its collectability and the contingencies if ever required.

To display this understanding of WIP will impress and engender confidence in your financier that the process of creating and collecting it is in sound hands and should allow a further asset and income stream to support your funding requirements - not to display it or to treat it lightly will not only limit the firm's borrowing capacity but increase the risk that the principals are carrying in the business unnecessarily.

To solve the intricacies of financing a plaintiff firm in a single article is not possible - to identify the major issue alone is a large task. However, financing is a core requirement of these growing businesses and it is in the interests of every principal to be aware of the issues.

The banking industry is becoming more polarised and the requirements of specialist firms such as plaintiff firms may well fall outside of the knowledge base and management capacity of the largest banks. From this article, I encourage you to stand back from your daily demands and look at your business with the eyes of a banker and identify a bank that will understand many of the issues that you face as a manager of a growing firm. The time spent investigating this could well reap great dividends. ■

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**Macquarie Bank** specialises in funding legal firms (including numerous plaintiff firms) and have supported APLA in each of the three National conferences held. They have specialists in each of Sydney, Melbourne and Brisbane.

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