

BUILDING BONDS

Practical steps
for administrators
to foster the
banking relationship





BY ED POLL

Once billable work is turned into collected cash, law firm administrators must manage the cash flow process so the firm remains solvent as a business.

Today's financial information systems can and do produce extensive and detailed cash flow data, but they cannot adequately handle the cash management process in themselves. However, administrators who properly prepare can turn to an experienced ally — the firm's banker.

Law firms are attractive customers for banks. Administrators should not hesitate to establish banking relationships because of stereotypical myths, such as "bankers only want to lend you money when you don't need it," or "bankers are under such tight controls by regulators that they won't or can't meet an unexpected lending need." The reality is that banks and law firms are both professional service businesses and can develop mutually beneficial and effective business relationships if they prepare appropriately. The administrator's preparation requires selecting the right bank, building solid relationships and structuring the optimum service package.

“We want a bank that knows our business and understands our problems as a professional service firm, and that doesn’t pigeon-hole us along with manufacturers and retailers.. We look for bankers to have a sense of urgency in answering our requests, and to maintain ongoing working relationships through contact people we know and can rely on.”

CHOOSING THE BANK

Not every lawyer can properly represent every client. Just as logically, not every bank is appropriate for every law firm. Administrators should look for a bank that gives them the types of services and responsiveness they want. Factors to consider include geographic convenience, asset strength, local or regional ownership, and likelihood of being acquired. Don’t shy away from banks that seem to emphasize doing business with other lawyers. The more they understand the profession’s dynamics, particularly with regard to cash flow and the management of IOLTA funds, the more helpful they can be.

Keep in mind that you should be forming a relationship with both a bank and a banker. In picking a bank, understand the niches in which it specializes – high wealth individuals, large commercial accounts, or small or mid-sized businesses. Get suggestions or recommendations from your accountant, local bar association and clients of the firm. Generally, your choice should depend on convenience and personal relationships rather than institution type, but be aware that different types of lending institutions exist to meet different needs and standards.

- National banks are commercial banks that elect to have a national charter, issued at the federal level, which subjects them to supervision by the Office of the Comptroller of the Currency (a division of the Treasury Department). Or they can choose a state charter, which brings both federal and state supervision and regulation. Either way, commercial banks receive deposits and hold them in a variety of different accounts, extend credit through loans and other instruments, and facilitate the movement of funds.
- Community banks are a special category of nationally chartered bank – small local banks that focus on small business loans. State-chartered banks that elect to join the Federal Reserve System are supervised

by federal regulators. The remaining state-chartered banks are supervised by the Federal Deposit Insurance Corporation (FDIC).

- Mutual savings banks (related to the old savings and loan institutions) are state-chartered savings institutions which originally were designed to accept deposits from individuals and make residential mortgage loans. Over time they have broadened the type of services offered and now are the functional equivalent of a commercial bank.
- Credit unions are not-for-profit financial cooperatives that initially required individuals to share a common bond for membership (like employment at the same firm) in order to receive loans and other consumer banking services. Today credit unions are mostly similar to commercial banks, although they are exempt from federal and state taxes due to their not-for-profit status and may have slightly more attractive rates because of this.

STRENGTHENING THE RELATIONSHIP

The lawyer/banker relationship must be open, candid and built on trust. Good bankers are creative people who will find a way to assist a good customer of the bank. Bankers can be more creative if they understand the lawyer’s goals and business, which requires you to maintain an ongoing process of education with your banker. Don’t just limit yourself to your loan officer or branch manager. Getting to know a senior manager – a vice president or even the president of the bank – will be your ally in the long run. Ensure that both the senior personnel and your regular contact understand your firm’s business, marketing and receivables plans.

Bankers view and understand any law firm as a business, with cash flow, receivables, revenue and profits, and need to assure themselves that your firm is a viable, ongoing business. The fundamental documentation of that fact should be collected and presented to the bank at the start of any new banking relationship. Key elements include:

- Partnership agreement or entity papers (corporate charter or LLP articles)
- Fiscal year-end financial statements for two to five years, prepared by an accountant
- Law firm tax returns for two to five years
- Personal financial statements and tax returns of law firm principals
- Evidence of business liability and malpractice insurance.

Most importantly, once a mutually supportive understanding is established, it is wise to share at least the general details of your firm's strategic, cash flow and marketing plans with your more senior contacts. This creates the context for the bank to better and more favorably evaluate your credit score and "4Cs" suitability when you make a loan request (see sidebar).

The insights of law firm managing partners stress the importance of such relationship building. Norman H. Levine, Partner (and former Managing Partner) at 100-attorney firm Greenberg Glusker Fields Claman &

Machtinger LLP, emphasized, "We want a bank that knows our business and understands our problems as a professional service firm, and that doesn't pigeon-hole us along with manufacturers and retailers," he said. "Responsiveness is equally important. We look for bankers to have a sense of urgency in answering our requests, and to maintain ongoing working relationships through contact people we know and can rely on. Our current bank is not a global giant, but it has the resources to serve us – and the desire and commitment to do so."

Marlo Van Oorschot, who heads a four-member team at the Law Offices of Marlo Van Oorschot, emphasized much the same requirements, but on a smaller scale. "I believe I get the personal service I need from my bank because my banker sees that I am a viable, thriving business," she said. "They know and have confidence in how we are managed, and can help with my business needs – whether it's financing our office facility, or covering occasional client check overdrafts."

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DEFINING THE SERVICES

Cash management and administrative services come at a price. Many firms don't realize that banks can be flexible on pricing and will add more services at the right price if your business relationship with them justifies it. A bank that knows the profession will offer sophisticated services and price them properly. That can include personal banking for lawyers and staff, plus credit card payment processing, IOLTA fund administration, cash collection and lockbox services, HR functions such as payroll and benefits administration, and a credit line.

Having a merchant account with your bank permitting payment by credit card can be an important source of revenue generation for any law firm, because it enables the firm to get access to funds faster and easier. Merchant accounts can be either trust or general accounts, and involve either direct cash deposits and withdrawals, or transactions by use of credit card. It is important to arrange that any dispute over fees paid by card will not be raised with or adjudicated by the bank or the credit card company. The proper forum for adjudicating the dispute remains with the State Bar disciplinary system and the courts.

FOUR Cs PLUS ONE

Banks make loans and extend credit to law firms using two general testing measures, one quantitative and one qualitative. The quantitative measure is your firm's FICO credit score. It estimates default risk, generally within the first three years of a loan, using a score that is based on the firm's history of borrowing and repaying money. The national median score is 720 and the top score is 850. Three national credit agencies – Equifax, Experian and TransUnion – provide credit scores and reports, and it is prudent to have this information before seeking a loan.

The qualitative factors to analyze your firm's creditworthiness are collectively the Four Cs:

- **Character.** The elements of character are honesty, integrity, ability and reputation in the community. They define the strength of the law firm's ethics and business practices.
- **Capacity.** This demonstrates whether the cash flow of the law firm is sufficient to repay the loan carrying costs (interest and related charges) and principal. A cash-flow statement showing the firm's turnover rate should be submitted to the bank for its consideration.
- **Collateral.** Collateral to guarantee loan repayment can be hard (real estate, office equipment) or soft (partner guarantees, securities, a lien on accounts receivable).
- **Capital.** Banks want to know how much equity (the debt-to-equity ratio) the law firm will contribute, especially for a loan to purchase equipment, real estate or another law firm.

For background on the bank lending process, see the websites of the Federal Reserve System (www.federalreserve.gov) and the American Bankers Association (www.aba.com), as well as Bankrate.com (www.bankrate.com, which also has comprehensive interest rate data). See also the special report by Ed Poll, The Successful Lawyer-Banker Relationship (<http://lawbizstore.com/books/the-successful-lawyer-banker-relationship.php>).



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In a credit line arrangement, the firm borrows and repays at will up to the amount of the credit line, which the bank regularly reviews and extends, increases or terminates as justified. It is neither advisable nor financially healthy to borrow for payrolls, partner draws and tax payments in anticipation of collecting on accounts receivable, in case the expected income does not materialize. There is no IRS problem with using credit line withdrawals for such purposes; the only question involves the credit line terms and conditions. This is a contract issue with the bank and a matter of the firm’s financial health.

MANAGING THE CASH

Cash flow management encompasses a full range of functions: depositing and managing cash receipts, using the credit line and securing a full-scale loan when necessary for a major capital investment or business transaction. If you have established an ongoing relationship with a bank so that it understands your law firm’s business dynamics and is comfortable with your business sophistication, the foundation will be prepared for the bank to quickly meet your needs.

Online financial services can facilitate cash management. For example, banks offer the opportunity to set minimum and maximum cash balances in the firm’s general account, with cash advances being drawn from a line of credit if the general account falls below the minimum. Banks can also provide for an automatic sweep on a daily basis. Establish a minimum amount of money to remain in your general account based on expected cash flow, then instruct the bank to segregate all funds in excess of this amount at the end of each day and sweep or transfer those excess funds into an interest bearing account until needed. Maintain separate payroll and general accounts. The general account should have only those funds necessary to cover the normal flow of checks presented to the bank for collection. To further facilitate cash management, negotiate for

a lockbox, which many banks now advertise as one of their premier business services. In this arrangement the bank picks up remittances several times a day, records them and sends details of the transaction to you as the customer within several days. Online technology allows communicating this information on the same day as the deposit, or on the day following the deposit.

AFTERWARD

Even if you have a solid relationship with your bank, it is wise to investigate the competitive landscape. For relevant information, network with financial professionals or ask other banks to submit a proposal for services. Two things are essential in this process: Make sure you compare the same or equivalent services, and make sure these have no hidden charges. If you learn that your current bank charges more for services than some competitors, draw on the relationship you’ve built over time. Talk to your bank, share the bids you received, say you value the existing relationship, and ask what the bank can do to maintain it – just as you would want the firm’s clients to handle a competitive legal services bid. Ultimately it can create a win-win situation for both the firm and its bank, strengthening your working dynamic. ■

About the author



Ed Poll, JD, MBA, CMC, Principal of LawBiz® Management, is a coach, law firm management consultant and author. He practiced law on all sides of the table for 25 years – as a corporate general counsel, government prosecutor, sole practitioner, partner and law firm chief operating officer. Contact Poll at 800.837.5880 or edpoll@lawbiz.com.