

Rarely a Borrower Be

When you are starting a new law firm, you will likely need to borrow some money, or at least establish a line of credit. Paying back the debt will a growing pain you will have to endure.

As your firm matures, you will have to consider from time to time whether to incur new debt. Sometimes borrowing money will be a sensible decision, but in a mature firm the need to borrow is sometimes a sign of serious trouble.

Borrowing Options

The table shows some law firm financing options, along with recommendations regarding re-payment.

Law Firm Financing Options		
Purpose of Financing	Financing Option	Recommended Repayment Plan
Tenant Improvements	Term Loan	Pay out loan over the life of the lease or less
New Technology	Term Loan	Pay out loan over the useful life of the technology or less
	Lease	Pay out lease over the useful life of the technology or less
To smooth out cash flow irregularities	Overdraft Protection	Keep overdraft limit as low as possible; return account to positive balance as soon as possible; suspend draws while in overdraft
To finance disbursements in injury cases	Line of Credit	Keep amount equal to or less than total of un-paid disbursements; apply disbursements portion of every settlement to reduce the outstanding balance; when disbursements become uncollectible, pay down the line of credit from general
To facilitate searches, transactions and filings	Trade credit accounts (e.g.: Land Titles)	Pay off accounts monthly; suspend draws in any month when accounts cannot be paid fully
To simplify accounting by using a credit card	Revolving credit	Pay off accounts monthly; suspend draws in any month when accounts cannot be paid in full
To finance draws v. receivables	Not recommended; if done, should be on Line of Credit	Pay line to zero as soon and as often as possible; suspend draws in any month when there is an outstanding balance at the end of the month
To finance draws v. WIP	Not Recommended	
To finance personal obligations	Not Recommended	

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Decisions with consequences

You may find my recommendations too conservative. However, if you are aggressive about using your credit and casual about paying off your debt, you will make your practice vulnerable. When there is a downturn in your revenues—and eventually there is always a downturn—you will find yourself squeezed from several directions:

- you will have difficulty keeping up with the current overhead expenses and disbursements needed to keep your business going
- you will have to spend time and energy fending off your creditors
- you will be unable to make capital investments (e.g., new equipment or software)
- you may not be able to take draws, resulting in extreme difficulties in your personal life

Sometimes, financial pressures produce ethical pressures. You may be tempted to forego a needed medical report because you still owe the doctor for the last three you ordered, or you may urge a client to settle more quickly than they should because you need the money. Your trust account may begin to look awfully tempting.

Sooner rather than later, your life will become a miserable round of temporizing measures as you try to balance the financial pressures. You will dread the daily calls from the bank and other creditors. Your bookkeeper will want to know where you are going to get the money for the rent, salaries and other payables. By the time the recovery comes—and eventually, there is always a recovery—you may be in so deep that you can never get out.

On the other hand, if use your credit conservatively, you have a better chance of building a sound, financially secure practice.

- if you use overdraft protection or trade credit accounts, you will pay them off in full every month.
- when you consider buying capital assets, you will try to finance them from cash flow. If that's not possible, you will structure your payments so the debt is reduced faster than the assets are used up. And if you can't afford the payments, you won't make the purchase.
- your bottom line will be, **debt always takes priority over draws**. You will not borrow to pay yourself and you will trim your personal needs to match your income. Although your draws will be less spectacular in the short run, they will be more stable and secure over the long haul.

The payoff will be that you will be able to concentrate on practicing law because you won't be distracted by financial worries.

Some may think that this is a counsel of perfection. I know it's not; I see plenty of law firms on both sides of this fence, and I can assure you that the ones on the conservative side are much happier and more secure than the others.

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