IS YOUR FIRM A VICTIM OF SHRINKAGE?

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I was recently contacted on the "hot line" by a law clerk with a puzzling assignment. The attorney for whom he worked was trying to decide what areas of practice to focus on, and which to eliminate or minimize. He requested the law clerk review several years of old files to determine which areas of law were most profitable. The problem faced by the law clerk was that the attorney had never recorded billable hours on any of his files. They were all contingent or flat fee matters, so timekeeping seemed an irrelevant exercise.

The law clerk wanted guidance as to how he should determine profitability in the absence of recorded hours to compare to income. The attorney had suggested that the thickness of the file be the measure of effort. But you and I know, and even the law clerk's instincts told him, that paper volume does not necessarily correlate with effort. The simple truth is that in the absence of accurate data, it's hard to make good business decisions.

Now consider the following scenarios. One of your firm's clients, the owner of a retail store, contacts your firm. He is concerned about a rather dramatic down-swing in revenues relative to inventory turnover. He believes he is the victim of Ashrinkage@. This artful term is used to describe undetected theft or other loss of inventory. Upon questioning, your firm discovers that there is a new manager in place. This person is quite good at sales, creating eye-catching displays, and directing the staff of the store. All other employees are long–term, and there has never been a shrinkage problem before the new manager was hired. The owner does not want to lose the first decent manager he has been able to hire. What does your firm advise?

In all likelihood, your firm will recommend immediate action of some kind, from hiring a private detective to implementing surveillance equipment to outright dismissal. And your firm will take other factors into account, like those which might lead to a claim of discrimination, defamation and so forth. What your firm probably will *not* do is recommend that the client ignore the situation, or mention the shrinkage in passing to the manager and leave it go at that.

Another client contacts the firm. This client is the owner of a small corporation. She has discovered that two mid-level managers, who are compensated for forty hours per week, have been arriving late, leaving early, and taking long lunches. She estimates they are really only working about thirty hours each week for forty hours of pay. In other respects, they do exemplary work.

This time your firm probably recommends immediate action of another kind. In all likelihood you will advise putting the employees on notice with a written warning, and making sure there is no misunderstanding regarding hours of employment. You will advise the client to include in the warning that failure to correct the situation will result in termination.

There is nothing unique about either of these vignettes. There is nothing in the hypothetical advice that raises an eyebrow. Yet, when a law firm finds itself in a similar situation, the action taken, if any, is very different.

What, you wonder, could a law firm have in common with a retail store or corporation? Like the retail store, law firms have inventory in the form of billable hours. And in spite of all the strides that have been made on alternative billing arrangements, the majority of lawyers and clients still worship the holy grail of the billable hour. Yet, when lawyers at the firm do not keep accurate time records, and do not hand in time sheets, the result is the same, or perhaps even more financially devastating, as the inventory shrinkage at the retail store.

Why do our firms tolerate those who do not turn in time sheets when they should, those who make them up from distorted memory on the last day of the month, or those who simply do not record a good portion of their time? If any worker in another industry performed that way in the handling of a client's inventory, the firm would be quick to indicate decisive action was needed. But firms shy away from imposing the same standards on their own lawyers and other timekeepers.

Consider the second vignette of the corporate managers who have shortened their day. Many firms have contacted me over the years about partners who have "retired" without the courtesy of informing fellow partners, or taking an appropriate reduction in compensation. And haven't we all seen someone who seems to Alive@ at the office, and been puzzled by their low billable hours? When this happens it means that the attorney is either Aself editing@ their time, or careless in recording it. Either way, the firm is missing out on billable time which would enhance its profitability. This is yet another cause of shrinkage of the law firm inventory of billable hours.

A difference in timekeeping habits makes a big difference in the bottom line. In today's competitive legal market and deflated economy, there is tremendous pressure preventing anything other than infrequent and modest hourly rate increases. Therefore, increased productivity is one of the few ways to improve the bottom line. If that increase can be obtained by better timekeeping habits, and no one has to work longer hours to earn the increase, what better incentive is there to take corrective action now?

What should a law firm do? First, start your new attorneys off right. From new grads to lateral hires, an attorney at the firm should be educated regarding the firm's time recording policies. It is a proven fact that time which is recorded several days after the work takes place will invariably "shrink". As much as 30 - 40% can be lost in a matter of days. In order to be accurate, time should be recorded each day without fail, and the time sheet should be handed in each day for the day before, or immediately recorded in the computer on systems where attorneys can input their own time.

If new attorneys exhibit poor timekeeping habits, take immediate corrective action, because the habits will only get *worse* over time, not better. The firm's administrator or office manager can communicate much of this information. However, it often will have greater impact coming from an attorney at the firm, such as the attorney's mentor or the managing partner. And it will have more clout if it is made clear that it is a factor which is directly tied to compensation.

Additional guidance is needed for all timekeepers regarding recording *all* time without editing. Take a close look at any attorneys whose billable hours are unusually low compared to the hours put in at the office. Are they self-editing? Poor recorders? Perhaps they need time management training, or a quieter workspace. For some, *more* hours at the office, or an adjustment to compensation may be the right solution.

The firm should educate young lawyers regarding ethical questions about time recording, such as what to do when traveling to one client while doing work for another, or making one visit to court on behalf of multiple clients. It's not a bad idea to cover these areas with laterals as well, to make sure they are on the same "page" as your firm. Although one would think all firms handle these situations the same, that is often not the case.

Take a look at the tools you've provided for timekeeping. Do you have a variety of timesheets available to accommodate the different recording styles of your attorneys, or is it a "one–size–fits–all" environment? Have you provided software like case management which has pop–up timers and text macros to facilitate easy and accurate time recording? Even Outlook's Journal function can be a real benefit to someone who otherwise has no tools to assist in accurate timekeeping. Remember, it's not the slow days that are problematic for time recording. It's the really hectic days, where lots of dollars are at stake, that tend to produce the least time recorded in the absence of appropriate tools.

Ok, you've talked about it at partner meetings. You've talked about it with new lawyers and paralegals. Unfortunately, there are those two lawyers who just can't Aget with the program@. They are good attorneys; one brings in a decent book of business, while the others' work is simply exemplary, and you depend on him to service your top clients. What do you do? Simple, put your money where your mouth is. Holding paychecks is problematic. But you can impose economic fines. You can and should also make sure there is discretionary income which can be impacted. For example, make a small portion of the attorney's salary subjective, and dependent on following firm policies.

Fines imposed should escalate quickly if the problem is not resolved promptly. They should be deductible from payroll if the attorney signed an authorization agreeing to the policy. Make it part of the employment agreement with the firm. As an alternative, the fines can be deducted from the expenses submitted for reimbursement by the attorney. (Check with employment law counsel before doing anything which impacts wages.)

If the first two methods don't make a difference, then it's time to directly affect compensation. For partners/shareholders, it can mean adding another subjective dimension to the review process. The firm should not only take timekeeping habits into account, but also aged unbilled work-in-progress, and past due accounts receivable. Most people hear the message better when it impacts their earnings.

What the firm should *not* do, under any circumstances, is ignore shrinkage by permitting poor time keeping and recording habits to perpetuate at the firm. Doing so denies the owners of the firm the profits they rightfully deserve. And consider the call which initiated this article in the first place. Even if you're a solo practitioner, you will some day want to analyze your matters and determine which are most profitable, and which are least. If you have never recorded your investment in the file, how will you know? Don't think memory will accurately serve you 5 or 10 years after the matter has concluded. Remember, in the absence of data, which includes accurate time records, it's nearly impossible to make good business decisions.

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