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Stop Leaking Profit!

Do you know how much profit from your client work carried out over the last 12 months may have been **lost** to your firm because:

1. Work has been under-priced?
2. You have not captured all the time spent on client work?
3. You have not turned all your recorded work in progress into bills?

These issues need to come with a **health warning** because they can result in ***Triple Discounting*** –

1. **Under-pricing** for a combination of reasons, including inadequate scoping and budgeting as well as lack of market knowledge and skills, and fear of losing work;

2. The problem is then made worse by **failing to capture all client matter-related hours**; and

3. Then, both during the course of matters and when billing, **recorded time is written off**.

These failings can seriously damage a law firm's financial health.

Taking each of these in turn

1. Are you under-pricing your work?

Accurately pricing legal services has often in the past been overlooked as a major dynamic of law firm profitability, more emphasis being given to other factors which can impact on profit. This has, I suspect, been due in part to several factors –

- Lack of understanding by lawyers as to their 'worth' to their clients and how they add value to clients;
- The straight jacket some law firms have created for themselves by becoming slaves to what are perceived as market hourly rates or quotes (when they have no clear idea what their 'market' is actually charging and whether such hourly rates or quotes will make them a profit or a loss);
- lack of knowledge as to what is involved in carrying out work for clients and its cost to the firm; and
- in the case of some lawyers, an embarrassment, and a lack of knowledge in 'talking about money' with clients.

Consider these questions:

How does your firm decide on what it will charge for its work?
Do you quote hourly rates and provide estimates based on those rates? If so, it begs the questions – 'How do you arrive at your hourly rates and your estimates?'
Do you exercise controls over how your people price their work or are they more or less free to agree with clients whatever they want?
When did you last increase your pricing, and was there any 'pushback' from clients?

Under-pricing your work by just £20 per hour could reduce revenue over a full year as follows:

Assume you have 30 fee earners.

Each captures 1000 client matter-related hours per annum = 30,000 hours.

Under-pricing by £20 per hour **= £600,000 lost revenue**

2. Are you failing to capture all client matter-related time?

Have you looked at how much of your people's productive potential is being lost and how that then impacts on your bottom line?

Managing Partners consistently tell me they estimate that, as a result of under-recording of matter-related time, they are failing to capture between 15% and 25% of their fee earners' time spent on client work. That can equate to a huge loss of potential profitability.

A useful way to begin finding answers (and solutions) to this question is to measure the time each of your fee earners (including partners) spends in the office each day and compare that with the amount of matter-related time they record each day (I use the term ***matter-related time*** and not chargeable time because use of the latter term implies that all time recorded will be billed, causing many fee earners to only record a reduced amount of time which they think they can bill).

It may be that not all matter-related time will eventually be billed to clients, but if even a small percentage of the time not recorded could be billed then firms would be more profitable – and no fee earners would have to work any harder! I was with a law firm recently and their partners and other fee earners present acknowledged (for a host of reasons) that they were each failing to record at least 30 minutes (some said it was nearer 1 hour) per day of the time which they were spending on client work. **How much time spent on client matters each day would your partners and other fee earners say they are failing to record?**

Failure to capture just 30 minutes of client matter-related time per day by each fee earner could reduce revenue over a full year as follows:

There are 220 working days p.a.
30 minutes of matter-related time not recorded per day = 110 hours p.a.

Assume 30 fee earners.
30 fee earners X 110 hours p.a. = 3300 hours p.a.
Assume an average charge out rate is £250 per hour.
3300 hours X £250 per hour = **lost revenue of £825,000**

'Non-chargeable time'
Do you know how much **'non-chargeable time'** your fee earners recorded during the last 12 months? Unless your people have specific non-client related roles, then their recording of 'non-chargeable time' (particularly under *'Admin'* and *'B/D'* codes) are likely to be used as dustbins to dump time they do not believe they can charge to client matters, or to make up their required hours for the day.
Accordingly, firms need to review fee earners' ability to record 'non-chargeable time'. I have seen recorded 'non-chargeable time' as high as 40% of total time recorded, and it is clear that much of that non - chargeable time is in reality time which should have been recorded as matter related time.

If you want to quickly increase your capture of client matter-related time, then remove the ability of fee earners to record 'non–chargeable time' unless they have real non – client related roles to perform or need to spend time on matters such as training.

It is also important to **educate partners and fee earners as to why full time recording is necessary.** Whether a firm prices its work on a fixed fee basis or charges by the hour, recording client matter-related time is an important **management tool** and as such is a vital element in building profitability:

- Time worked on a matter is only one factor to be taken into account in arriving at the 'right price for the job', but without knowing what will be involved in managing work then controlling costs will be difficult if not impossible;
- If fee earners under-record time on files, then they are pre-judging the decision as to what is the right price for the job;
- It will not be possible to safely quote a price for similar work in the future based on files where time has not been fully recorded.

The clear message to partners and fee earners should be:

'If time spent relates to a client matter, then fully record that time so the firm:

- **will have a complete record of what work has been done for the client; and**
- **can make an informed decision as to price when billing the matter.'**

3. Are you writing off the value of recorded time which could properly be billed to clients?

How much work in progress has your firm written off in the last 12 months?

Writing off the value of recorded matter-related time causes law firms to haemorrhage a great deal of profit. For example:

Assume a firm has 30 fee earners.

Each captures 1000 client matter-related hours per annum = 30,000 hours

Each fee earner writes off 200 hours of their recorded time = 6000 hours in total

6000 hours X average charge out rate of £250 per hour **= £1,500,000 lost revenue**

In the above example, if the write off in the value of work in progress can be reduced over the coming 12 months by 50%, then the improvement in profit would be £750,000.

Accordingly, check your **realisation rate**, which is the percentage of the value of recorded work in progress on a matter which is billed to a client.

NB – your realisation rate is unlikely to be an accurate figure because there may not have been full matter-related time recorded on the file in the first place.

Introduce a write off policy such as the following to **control** the writing off of recorded time –

'All WIP to be written off more than [£100] or [5%] of the recorded time, whichever is the higher, must first be approved in writing by the [managing partner]'

However, as is the case with many law firms, a great deal of billing is left to the last few days of their financial year. There may therefore still be the opportunity before the end of this month to improve profitability to some small degree by controlling write offs of time on matters still to be billed.

Actions to take in your next financial year about to begin.

I often find that law firms will only take action to 'stop their leakage', once they have discovered, to their shock, the amount of potential profit they have lost over the past year. Once that 'loss' is known then a plan can be put in place to stop the leakage. Accordingly urgent measurement of these matters is needed.

However, to achieve improved profitability over the coming year in relation to these matters, will mean that partners in particular will need **discipline** to do what is required, and should undertake to each other to be **accountable** for their actions.

Your plan to improve profitability in your new financial year?