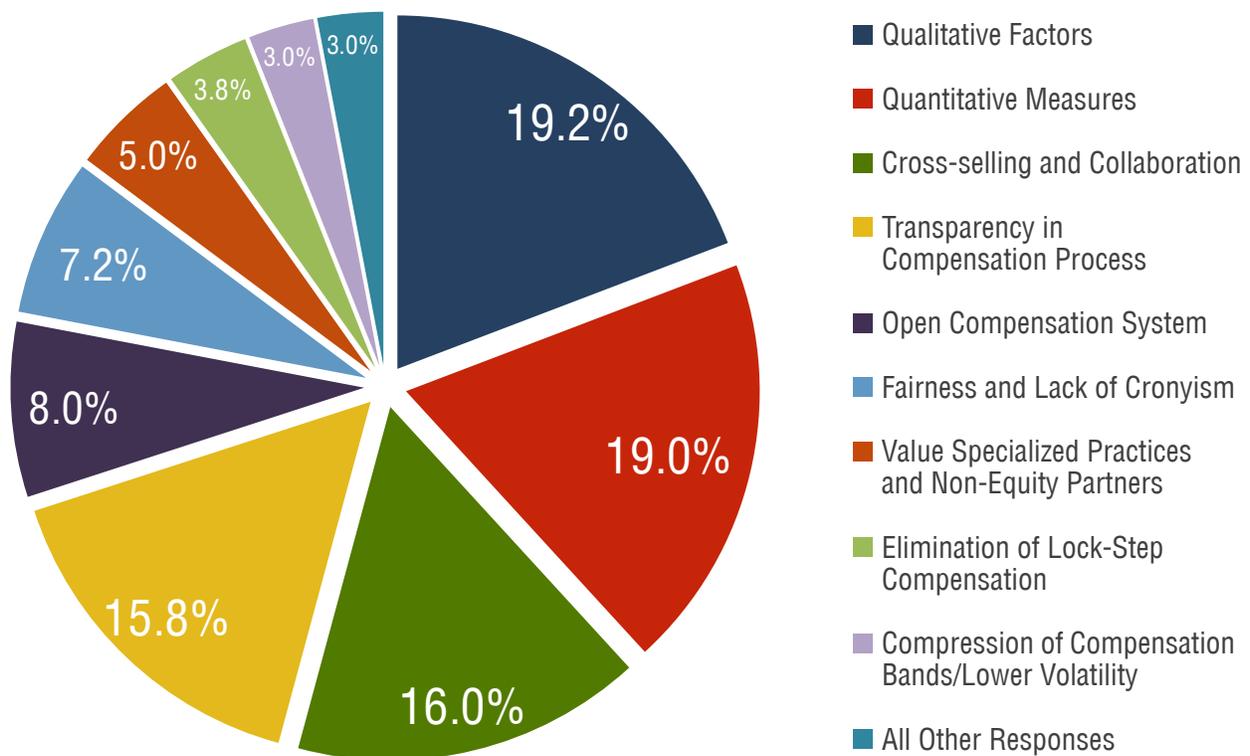


CHANGES LAW FIRM PARTNERS WOULD LIKE TO SEE IN THEIR COMPENSATION SYSTEMS

- RONALD J. NYE

In connection with its 2014 Partner Compensation Survey, Major, Lindsey & Africa® asked the 2,083 respondents whether they would like to see any changes in the compensation methods used by their respective firms and, if so, what changes they would like to see. Although one would expect the answers to that question to be as diverse as the 1,150 partners who answered it, the vast majority of the responses can be grouped into nine (9) general categories. Set forth below is a pie chart showing how those responses broke down by general theme, as well as a brief discussion of what these partners were really saying about their firms' current compensation systems.



QUALITATIVE FACTORS

 The largest group of respondents (19.2%) argued that qualitative factors (as opposed to quantitative measures) should be given much greater weight when determining partner compensation.

These partners would like their firms to adopt a more holistic approach to compensation that evaluates a partner's overall contribution to the firm beyond financial metrics. In their view, if

firms are committed to certain values, they should reward partner behavior that reflects those values. The qualitative factors that were specifically noted included: firm management, client management, quality of legal services, good behavior and citizenship, mentoring junior partners and associates, community involvement, commitment to diversity, speaking engagements that raise the profile of the firm, and pro bono representations.

The largest group of respondents argued that qualitative factors (rather than quantitative) should be given much greater weight when determining partner compensation.

3.6% of the survey respondents argued for greater compensation to firm administrators and managers, and 3.2% of the respondents argued for greater compensation for partners who engage in significant client management, whether or not they are responsible for originating such client relationships. One respondent wrote:

Significant non-billable hours spent on firm and practice group management and client and business development should be factored heavily into compensation. There are a lot of people at our firm who bill a lot of hours and are paid very well but do little or no work that benefits the firm in other ways, and the management of the firm and the practice group is left to others who end up spending tremendous amounts of time on vital non-billable and firm and practice group management tasks to the detriment of those individuals' billable hours and total compensation.

Another respondent thought that the compensation process should have "less reliance on formulas and more consideration of intangible contributions." These partners believe that the compensation system should foster partner behavior that builds the firm's brand in the marketplace.

Although an emphasis on qualitative factors is what these partners want in theory, several partners

recognized the difficulty in implementing a compensation system that heavily weighs qualitative factors when determining partner compensation. One respondent stated that he would like to see more qualitative factors included in the compensation process "but it is easier said than done [since] intangibles by their very nature are hard to measure."

QUANTITATIVE MEASURES



In contrast to those who advocated on behalf of qualitative factors, the second largest group of respondents (19.0%) argued for a greater emphasis on quantitative measures, such as client and matter originations, profitability of individual partner practices, working attorney collections and billable hours. Of this 19%, 84% of those respondents argued for compensation systems in which client and matter originations are given the greatest weight, while 16% of those respondents argued for compensation systems in which working attorney collections and billable hours are given the greatest weight.

Interestingly, however, many of the respondents who were proponents of quantitative measures guiding the compensation process within their firms specifically noted that the manner in which quantitative measures are allocated (such as client and matter origination credit) needs to be revised to more accurately reflect the reality of how and why clients are giving certain work to their firms. Said one respondent, "I would like to see a more nuanced system of origination credit that allows multiple contributors to be credited on some sort of weighted basis." In addition, many respondents argued that the profitability of a particular partner's practice should be analyzed beyond the raw origination or working attorney numbers. To analyze the profitability of a practice, economic inputs such as salary, overhead, write-offs, marketing and any additional costs that are incurred in order to originate such billings or collect such working attorney statistics should be considered. One respondent noted:

I would like to see more value placed on partners spending time actually “thinking” about ways to manage and improve their individual business so that they remain profitable in this rapidly changing legal environment and then executing [on it]. This is different from marketing. This is more about developing a plan to keep partners’ overall practices relevant and profitable in a changing legal landscape.

Another wrote that “greater attention needs to be paid to the relative profitability of originations in valuing partner contributions. Too many partners are rewarded for work that is unprofitable and no one seems to pay attention to that issue.” Whether scrubbed for profitability analysis or not, these partners want the certainty of tangible quantitative measures to determine their compensation.

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- PARTNER RESPONSE

CROSS-SELLING AND COLLABORATION



Significant credit in the compensation process for cross-selling and collaboration was advocated by the next largest group of respondents (16.0%). According to these respondents, partners who cross-sell services to their existing client base, as well as those who collaborate on client and matter pitches in order to generate additional revenue for their firms, should be rewarded for that behavior with compensation that reflects those cross-selling and collaboration efforts. Similarly, these partners believed that in order to fully service clients across practice areas and geographies, partners with distinct expertise and located in diverse geographic areas must be incentivized to collaborate with one another to meet client demands, and that having a compensation

system that recognizes and rewards that behavior would benefit the firm. Presumably, the result is better client service and a greater likelihood of repeat as well as new and expanded business.

One respondent who strongly believed in the benefits of cross-selling and collaboration, argued for a complete overhaul to his firm’s compensation system. He said that his firm’s compensation system does not encourage cross-selling or even having the right subject matter expert work on a client’s case. Instead, it discourages teamwork and breeds in-fighting. Another respondent wanted “greater emphasis and acknowledgment on cross-selling and building industry teams with compensation benefits distributed to active and successful teams.” Whether formalized in the compensation process or addressed by the manner in which quantitative metrics are allocated for client and matter origination, many of the respondents complained that their firms’ billing systems and/or compensation systems do not take into account the contributions of multiple partners who work in a team approach. Several respondents noted that their firms need to give more consideration and support to client teams and to the originations that these client teams bring to their firms.

GREATER TRANSPARENCY



A greater transparency surrounding the compensation process itself was advocated by 15.8% of the survey respondents. In particular, they argued that both the criteria that are evaluated in order to make compensation decisions and the committee deliberations themselves should be open to all equity partners, rather than to a select group on the compensation or management committee. Even in firms with open compensation systems, some partners viewed the compensation process as a “black box” because they have no information as to how the reported compensation decisions are made. One respondent noted “we have an open compensation system, so I know how everyone else is compensated. What I don’t know is why the others are compensated the way they are. I’d

like to have more insight into how the decisions are made and what the metrics are for each level of compensation.” A large number of these respondents would like to see a compensation system with clearly defined and articulated benchmarks that if met result in a specified compensation.

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One of the greatest complaints these partners have is the fact that they do not know from year to year what criteria the relevant committee is valuing and at what relative weight of importance. One respondent wrote that firms should “quantify the importance of the variables in the compensation equation to level the playing field.” Partners are looking for greater clarity on the weight given to different metrics that are taken into account in the compensation process, and clear feedback after decisions are made as to the requirements necessary for the next level of compensation. One respondent, who believes there is not a lack of information as much as there is a concerted effort on the part of management at his firm not to explain the reasons for compensation decisions, wrote “a great deal of information is available but management makes little or no effort to explain the connection between specific personal accomplishments or short comings, and pay. To the contrary, management is enraged by any systematic attempt to understand a relationship between available information and compensation.”

Many partners believe that the lack of transparency extends beyond the published decisions of the compensation or management committees. Several partners want greater transparency at the conclusion of the compensation process. In many instances, compensation decisions are published without any meaningful discourse between the individual partners and the relevant committee that made the

decision. These partners feel that they have the right to fully understand why a particular decision was made regarding their compensation.

OPEN COMPENSATION SYSTEM

 The next largest group of survey respondents (8.0%) argued that their firms should move to an open compensation system. This is separate and distinct from those who argued for greater transparency in the compensation process. An open compensation system is one in which individual partner compensation is known by each of the equity partners of the firm and, in some instances, certain quantitative metrics relating to each partner (such as originations, collections, and working attorney statistics) are also disclosed to each of the equity partners. One respondent stated that “closed compensation systems allow the decision makers to unfairly compensate people – both high and low.” Closed compensation systems, when not 100% closed, can breed discontent among the partners who have enough information to be upset about their compensation, but not enough information to have a complete and accurate picture of it. Many respondents, including some who were not part of the 8.0% advocating for an open compensation system within their own firms, argued that regardless of the type of compensation system employed by their firm, the compensation of non-billing firm management should be open to all equity partners. One such respondent noted that “firm management compensation should be open to all. The firm needs to migrate away from the notion that 2-3 attorneys own the firm and everyone works for them.”

FAIRNESS AND LACK OF CRONYISM

 A greater sense of fairness and a move away from perceived “cronyism” and overcompensation of firm management by firm management was the change that the next group of the survey respondents (7.2%) wanted to see. One respondent argued for “less disparity between

executive committee compensation and the rest of the partnership,” while another wanted to see “less favoritism to friends of those on the compensation committee.” In addition, several respondents believed that those who serve on the management committee of their firm should not also serve on the compensation committee. Divorcing the two would give a greater perception of fairness and independence of the compensation process from firm management, as it significantly lessens the notion of the firm being controlled by a small group of partners within the firm. One respondent refined the point regarding overcompensation of firm management by proposing that the compensation system differentiate between management functions that are connected to client service and business development and those that are not. This system would reward management functions that are related to client service and business development to a greater extent than it would for management functions that are not so related.

VALUE SPECIALIZED PRACTICES AND NON-EQUITY PARTNERS

 Five percent (5.0%) of the survey respondents said that greater compensation should be paid to partners in highly specialized practice areas as well as to non-equity partners who are integral to successful client relationships within the firm. The comments focused on specific client service rather than on any quantitative metrics relating to such partners’ practices. Specific practice areas that were referenced as specialty practices included: several regulatory practices, patent litigation, and trust and estates. One respondent noted that “there should be more value placed on marketable expertise. I practice in a niche area. It is a product that is easily sold to clients in need. Our firm should recognize that not all practices are as easy to sell, or as likely to be billed at premium rates.”

Non-equity partner respondents equally believed that their contributions to their respective firms

were undervalued. One respondent wrote “the mindset that any warm bodies can perform the work is a misguided fallacy. The entire private practice profession is becoming stratified into two classes: highly paid rainmakers and a class of underpaid working partners who service the clients and where the real lawyering skills flourish.” Another respondent noted “non-equity partners are the most highly leveraged attorneys at our firm. Expected contributions (the difference between collections goals and actual costs including overhead) increases every year, yet non-equity partners by definition do not see any of those profits. Collection goals have increased rapidly with no commensurate increase in compensation. The disparity between those should be lessened.”

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Lastly, it was noted that the compensation process for non-equity partners was not nearly as comprehensive as the compensation process for equity partners. One respondent wrote “there doesn’t appear to be any substantive review for non-equity partner compensation, and the memos that are prepared are known not to be reviewed by the compensation committee.”

ELIMINATION OF LOCK-STEP COMPENSATION

 The next largest survey response (3.8%) came from partners who argued for the elimination of their lock-step compensation system. This would allow both faster increases and faster decreases in compensation as individual attorney production warrants such changes. In addition, these partners felt that by eliminating the lock-step, seniority alone would no longer be a factor in how

much a particular partner is paid. In a lock-step system, partners “earn” a greater share of firm profitability merely by seniority rather than as a reward for productivity and performance. Younger partners who are producing see this as a real impediment to receiving “market” compensation based upon their production. Upward movement in their systems is very slow and does not necessarily track the speed at which their books of business grow. Conversely, partners with seniority whose books are in decline generally see their compensation adjusted downward at a slower pace, which makes the younger productive partners feel that they are carrying these more senior partners. One respondent noted that in the lock-step system “senior attorneys simply hold on while their practice fades away and make as much as they can before they leave.” Another wrote that the firm needs to rely less on seniority and historical performance, as some senior partners are overcompensated merely because of their tenure at the firm and because of what they produced as a historical matter: “Senior partners who are no longer bringing in substantial business need to be making less; and younger, more dynamic partners who are generating more business need to be making more.” These partners are looking for a move away from lock-step and toward some form of meritocracy.

COMPRESSION OF COMPENSATION BANDS/LOWER VOLATILITY



The final group of categorized respondents (3.0%) argued for a compression of the bands of compensation within their system and a resulting move toward less volatility in compensation from year to year. With fewer compensation bands, movement among them is more restricted leading to less volatility in an individual partner’s income from year to year. In addition, there will be a greater perceived fairness in the system because small differentials in production will be less likely to result in different compensation bands for otherwise similarly situated partners. One respondent noted that in their current system “each partner now can

make a different amount and percentages are broken out to the one-hundredth of a percent.” Another partner noted that “a limit should be set on the maximum compensation differential between the higher paid and lower paid partners” in the firm: “Narrow the discrepancy between the haves and the have-nots. Some people make multiples of others, even though the lower paid individuals work hard, bring in a lot of receipts and sacrifice a lot.” With respect to the volatility of compensation from year to year, the fewer the number of compensation bands, the “less potential for downward movement based on an off year.” Further, some non-equity partner respondents argued to not only lessen the compensation gaps between equity partners, but to also lessen the compensation gaps between equity and non-equity partners. It was clear that the vast majority of the survey respondents in this category perceive themselves to be at the lower bands of compensation within their firms.

CONCLUSIONS

Not surprisingly, when you ask over 2,000 lawyers an open ended question about the changes they would like to see in their firms’ compensation systems, the answers are very personal and are shaped by the real life experiences that they have had with the compensation process at their respective law firms. It is clear from the responses that the compensation that lawyers receive from their firms is important for reasons that go far beyond economics. Compensation is often viewed by lawyers as an indication of how they are valued by their firm. There is a deeply emotional component to the compensation process because it is typically the only means by which a firm evaluates an individual partner’s performance. Partners want to be valued by their firms; therefore, they want their firms’ compensation systems to value most heavily the measures and factors that put them and their practices in the best evaluative light. For example, it is likely that many of the respondents who argued to heavily weight qualitative factors in the compensation process do not have strong quantitative metrics of the type most valued by their

firms. Similarly, it is equally likely that a large number of the respondents who advocated for quantitative measures to be the leading factor in determining partner compensation have strong quantitative metrics and do not spend as much time on the activities articulated as qualitative factors.

It is also clear from the responses that the compensation system within a firm drives its culture. It shapes partner behavior both positively and negatively. If, for example, firm management believes that cross-selling and collaboration are behaviors that will help grow the economic pie for the partnership, the compensation system needs to take cross-selling and collaborative successes into account. If the system does not reward those behaviors, partners will not engage in cross-selling and collaboration, rather they will engage in the types of behavior that are rewarded by the compensation system. Lastly,

regardless of the behavior that a firm is trying to promote among its partners, it is clear that partners want a clearly articulated set of criteria against which they are to be evaluated and they want that criteria consistently applied across the partnership. Transparency in result and in process positively affects the perception of fairness with respect to the compensation system.

It is clear from the breadth of the answers to this question that no single compensation system is going to be universally heralded by the individuals who make up a law firm partnership as the “perfect” compensation system. Partners are individuals with very individualized perspectives on how their firm should compensate its partners, but as shown by the responses there are a very finite number of ways in which these partners would like to see their firms’ compensation systems change.



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