The Wise and the Innocent Ways Partners View their Firms' Compensation Systems

And the opportunity they reveal for cost-free improvement in partner satisfaction

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Half of Big Law's most-productive equity partners want to see change in their firms' comp systems. This is an arresting observation. I've seen the comparable statistic for consultants, investment bankers and physicians: groupings of these professionals typically report less than half this appetite for change. Law partners' discomfort is especially striking because one would expect today's frothy comp levels to dampen such feelings markedly.

The primary change equity partners seek is to have the mechanism by which individual compensation allocations are determined be made more explicit: what factors are considered, how are they assessed, and what are their weightings? They believe there's extensive favoritism and cronyism.

Managing partners have a choice. They can view these sentiments as simply a manifestation of lawyerly proclivity to find fault. This is questionable, not least because consultants are similarly profligate with their ability to identify potential for improvement. Alternatively, firm leaders can accord them some legitimacy—after all, when it comes to managing people, feelings are facts—and try to tease apart its different layers, and develop an action plan appropriate to their firm's circumstance.

If managing partners take this second approach and are honest with themselves then many will acknowledge that their equity partners have a point. Comp systems are living organisms that have evolved incrementally to accommodate idiosyncratic situations, exigencies, and personalities. As a result, many comp systems fall short of being principle-driven, incisively-equitable, and fine-tuned to further a firm's strategy. The reason managing partners don't provide partners clarity on how their systems work is simple: they can't—their workings aren't clear.

In order for managing partners to make their systems more objective they have to acknowledge to themselves one other reality: subjective systems suit managing partners. It affords them an element of control—the power of the purse can beget compliance. In the herding-cats environment of a law firm partnership, such influence is not to be relinquished lightly.

However, a balance can be struck. Comp systems can be designed to provide greater clarity and yet retain an element of managerial discretion. The key is to delimit explicitly the portion of the comp allocation that is discretion based, and to define the criteria and process by which such discretionary sums are, and are not, allocated. In my experience, the majority of partners are accepting of management retaining discretion when management is open about it; it's the furtive that creates concern. Further, managing partners should not discount the power of even small compensation amounts—as many know all too well, partners can take umbrage over even slight differences with other partners.

The following lays out the data on equity partners' desire for change, discusses the dynamics around these desires for different equity partner segments, and outlines a compensation framework that combines objectivity and discretion.

DESIRE FOR CHANGE

Partners' perspectives on their firms' comp systems were explored in the Major, Lindsey & Africa 2018 Partner Compensation Survey. In total, the survey received responses from 1,261 partners; the present analysis focuses on the 663 full-time equity partners within this group who provided answers to the full set of relevant questions.

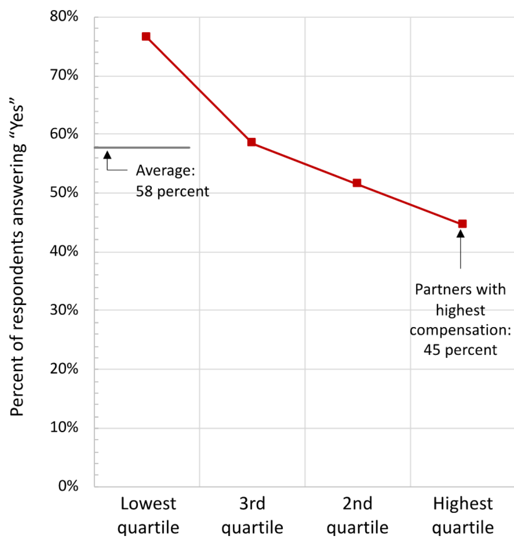
In aggregate, 58 percent of equity partners reported a desire to see change in their firm's comp system. Not surprisingly, the desire for change varies with partners' compensation and commercial productivity (as reflected in originations), being stronger among partners with lower comp and originations, see figure below. The salient point is that even for the most commercially-productive partners, specifically the top 25 percent ("highest quartile") by originations, over 50 percent want to see change. In other professional services settings this number is typically around 20 percent. This desire for change is particularly striking given where we are in the business cycle.

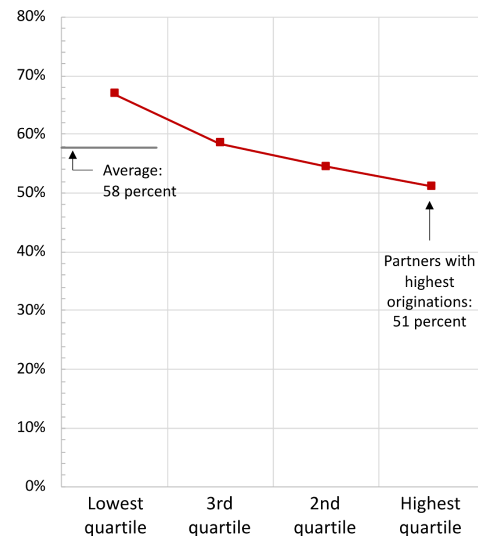
Those partners who responded that they'd like to see change in their firms' comp systems were asked what such changes they would like to see. The open-format responses had a single major theme: 52 percent of the responses related to a desire for greater clarity in how individual partner compensation allocations were determined.

Partners' desire for change

Q: Are there any things about your compensation system that you would like to see changed?

Source: Major, Lindsey & Africa 2018 Partner Compensation Survey. No. of respondents (N) = 663. Respondents were given response options of "Yes," "No" and "Don't know/not sure."





This sentiment came in a number of different flavors. Some spoke directly to the desire for clarity:

- *A clearer explanation as to how Compensation is set, what the Compensation Committee values in reaching its decisions each year.*
- *Clear list of factors taken into consideration in determining pay as well as the relative weight for each factor.*
- *More transparency around how metrics relate to compensation and why certain practice groups have higher compensation levels*
- *A clearer explanation as to how Compensation is set, what the Compensation Committee values in reaching its decisions each year and a better understanding of whether and how certain partners may exert influence on the CC with respect to their individual Compensation (perhaps to the detriment of others).*

From others, the same general sentiment was connected with consistency, fairness, and alignment with firm strategy:

- *Too much subjectivity—rules tend to change some from year to year—hard to know what goals should be. Need more objectivity to apply across partner situations.*
- *Compensation should actually support the strategic goals of the firm. Instead it is ad hoc and detached from the stated criteria and goals.*
- *I would prefer more definite metrics or a lockstep system. Ours is too subjective. There are partners billing 1200 hours consistently, with no book of business who make lots of money; while there are others, who consistently bill many more hours with modest books of business, who are paid very little and are on the brink of expulsion.*
- *Consistency—partners with lesser performance are being paid more than those with greater performance.*

Others suspect a paucity of clarity is enabling favoritism:

- The friends of and those who work closely with practice group leaders and executive committee members receive a disproportionate share of the partner compensation and bonuses.
- I'd like to see us reduce the amount of politics in the compensation system—it creates situations where underperforming partners are paid significantly more than appropriate for years.
- We need more fairness across the firm in comp. And no special favors for select people—in other words: no favoritism!

Yet others go further and believe it leads to self-dealing:

- Our system is not routinized enough to be fair. Each year the compensation committee pays themselves the most of all partners and everyone else is adjusted to whatever scheme allows that to happen.
- The members of the executive committee, which is too big, are paid way too much, including

outsized bonuses. They should not be the highest compensated members of the firm. It is an appearance of impropriety.

Separately, all respondents were asked if they felt their firm exercised any of a particular set of biases in determining compensation. The results are summarized in Table 1. The concerns underlying the comp system changes desired are echoed here. A particular contrast in the numbers stands out: the number of partners who believe their firm has a cronyism bias is essentially the same as that who believe their firm has no bias at all (36 and 37 percent, respectively).

I find this stunning. Everywhere you go in professional services, you'll see suspicion of cronyism. But not at this level. Is something amiss in the legal world? Law firm partners are smart people; at the majority of firms they see the data. It is hard to escape the implication: cronyism is rife across law firm comp systems.

Table 1: Compensation biases

Do you feel your firm exercises the following biases when determining compensation?	Percent of respondents
None	37%
Cronyism	36%
Bias against home-grown partners	13%
Gender bias	12%
Bias against laterals	7%
Racial bias	4%
Sexual orientation bias	1%
Other bias(es)	9%

Source: Major, Lindsey & Africa 2018 Partner Compensation Survey. Question read: Do you feel that your firm exercises any of the following types of biases when determining compensation? Select all that apply. Responses shown are for equity partners only.

DYNAMICS BY PARTNER SEGMENT

Table 2 on the following page shows how the percent of equity partners looking for change varies across different partner segments.

Women are appreciably more eager than men (by 10 percentage points) to see change in their firms' comp systems. The driver of this is a difference in perspective on the existence of a gender pay gap: 70 percent of women partners believe such a gap exists; only 10 percent of men believe likewise. In only a quarter of firms has management aired the issue of a possible gender pay gap with their partners. I find this a surprisingly low number. Even if groundless, the fact that the perception exists broadly among women partners is grounds for addressing it—when it comes to people, their perceptions are the reality leaders have to manage.

Airing the issue with partners will take some deft handling; it's an emotional issue, as demonstrated by the undercurrents in partners' comments on the topic:

- *We are conducting an analysis of pay based on gender. However, having spent a good bit of time in law firm management, it is clear that any bias in comp has been favorable to women and minorities in our law firm.*
- *Management is addressing the issue to the extent that they have meetings in which they deny it exists and admonish women to 'stop complaining.'*

These sentiments indicate that a robust, neutral, fact-based, assessment could play an important role in any exploration of the issue. On this, management teams should be open-minded about the potential for gender bias in the quantitative metrics used in guiding compensation. It seems reasonable to me that differences in behavior could lead to the contributions of women partners being under-reflected in certain such metrics. Some survey comments suggest some male partners may be reticent to acknowledge this possibility, for example:

- *Equity partner compensation is based entirely on a formula based upon collected origination dollars, timekeeper dollars and credit for primary responsibility for heading cases regardless of origination, so there is no potential for gender bias.*

Partners with over 20 years as a partner are less inclined (by 5 to 8 percentage points) to want change than partners in younger cohorts. This difference could be interpreted as simply in line with economic self-interest as most comp systems reward tenure independent of, and in addition to, economic contribution as measured by originations. However, this explanation isn't entirely satisfying as it should lead to smoothly declining desire for change with increasing years as a partner; such is not seen in the

Table 2: Desire for change by segment		
Segment	**No. of respondents by segment (N)**	**Percent would like to see change**
All partners	663	58%
Men	501	55%
Women	162	65%
0 to 5 years as partner	72	60%
5 to 10 years as partner	112	62%
10 to 20 years as partner	249	59%
Over 20 years as partner	230	54%
Closed system firms	124	65%
Open system firms	539	56%
Lockstep firms	95	54%
Non-lockstep firms	568	58%
Homegrown	323	61%
Lateral	340	55%

Source: Major, Lindsey & Africa 2018 Partner Compensation Survey. Question read: Are there any things about your compensation system that you would like to see changed? Respondents were given response options of "Yes," "No" and "Don't know/not sure." Data shown are "yes" responses as a percent of total responses (equity partners only).

data. Rather the data are consistent with cronyism: the 20+ year cohort is the one that would dominate executive and compensation committees at most firms; if cronyism was happening then one would expect to see this cohort be more satisfied, which is what the data show. Thus, it maybe be more accurate to view these data as reflecting partners' sense that there's cronyism at play rather than they simply manifest young partners feeling entitled to higher comp.

Closed system firms are those where partners do not know what each other earn. Partners at such firms are more eager than their counterparts at open system firms (by 9 percentage points) to want change. Within closed systems firms the desire for change is strongest for partners in their early years: 85 and 77 percent of partners in years 1 to 5 and 5 to 10, respectively, want to see change. Far-and-away the number one change sought by these younger partners is to switch to an open system, who are suspicious that their firms' closed systems have an excessive bias in favor of older partners:

- *Open the system and provide clearer benchmarks for salary*
- *Open/partially open and clear performance metrics.*
- *I'd like it to be an open system. It seems the firm favors partners who have been at the firm for more than 30 years and pays them more than they deserve.*

There may well be a second, less openly-stated yet more strategically poignant, basis for the discomfort. Partners at closed system firms are generally aware that they earn less than their counterparts at open system firms. It follows logically that closed system firms are generally less profitable than their open system counterparts. Behavioral economists would expect this: seeing what others earn encourages individual hustle, and hustle drives profitability. Leaders at closed system firms would argue that their firms forego the marginal dollar of profitability in exchange for a more collegial environment that fosters greater professional satisfaction among partners. However, the data don't evidence that such is happening: partners at closed system firms report no greater level of professional satisfaction than do their peers at open system firms.

More than half of partners at lockstep firms (54 percent) want change in their comp systems. While this is below the average by 4 percentage points, it is surprising that more than half of partners at lockstep firms want a change. After all, at some level they choose to be at a lockstep firm and lockstep systems, whatever their issues, are clear on how individual comp allocations are determined.

Again, the partners' comments reveal two different issues. One is a desire to have greater variability around the firm lockstep:

- *We need more flexible lock-step and compensation more closely tied to origination.*

The second is the issue you'd expect to see arise as more and more firms have moved further from strict lockstep through bonus pools, uncapping the top end, etc.: discomfort with how these off-lockstep comp allocations are being made:

- *I'd like identifiably, objective stated metrics for determining salaries when variances are made to the lockstep procedure.*

Homegrown partners have a stronger desire for change (by 6 percentage points) than their lateral counterparts. Driving this is the 23 percent of homegrown partners who believe their firm's system is biased against them:

- *We routinely over pay mediocre laterals, which takes money out of the pockets of incumbent partners.*
- *I'd like more comp consideration for long time lifers instead of throwing cash at laterals. A good saying heard around the firm is gosh, I wish I could leave and lateral back in.*

One can understand how this sentiment arises: while 40 percent of laterals move for little-or-no change in comp (plus-or-minus 10 percent), 50 percent do see increases of over 10 percent. However, there's a certain innocence in this view. Presumably, homegrown partners only want laterals who are going to stay; the retention rate of laterals is higher for those who move to higher PPP[1] firms; and one would expect a move to a higher PPP firm to come with an increase in comp.

Homegrown partners should also be cognizant of the lateral's perspective. Over 11 percent of lateral partners (as distinct from the 7 percent of all partners shown on Table 1) believe their firm's comp system is biased against them. This often goes unappreciated. Firms hire laterally more often for new than for well-established offices. This means laterals are disproportionately located in offices away from the seats of power. Given the favoritism that partners believe is rampant in comp systems, it's no surprise to see laterals feeling that they're missing out:

- *There is some mild bias, I believe inadvertent, against partners in smaller offices.*
- *Bias in favor of partners who are (i) homegrown and/or (ii) based in the firm's main office*
- *Office-based bias—lawyers in home office are compensated better than others*

There are other, less canny, factors at play too. Laterals have experience of at least one other firm's comp system, which may mollify a desire for change. And laterals have had their compensation expectations sanity checked by the market and hence may be more grounded. And then, of course, home grown partners should probably be mindful that when it comes to laterals, as with so much else, the market price is the market price, as succinctly encapsulated by Bo Diddley in Trading Places: "In Philadelphia, it's worth $50."

A FRAMEWORK FOR OBJECTIVITY AND DISCRETION

At their core, compensation systems seek to reward partners for three distinct things: ownership of the firm, generation of profit, and being good citizens:

- *The price-point a firm realizes in the marketplace today, and the profits to which it leads, reflect many years of brand building and investment by partners in prior years. The longer-tenured partners who made these investments logically deserve an annual return separate from that due for their in-year contributions, just as would be provided to the outside owner of a conventional business who provided its founding and growth capital.*
- *Partners should be rewarded for the profit they generate for two reasons: one, it is only fair that those who contributed disproportionately to a firm's profit pool should draw from it in like fashion. Secondly, sustaining and growing profitability is critical to a firm's vitality; thus, it is important that incentives be provided for such activity.*
- *For law firms to be attractive places for partners to work they have to offer both strong compensation and a compelling environment at which to practice. A critical element of this latter is how partners work together: helping each other in executing client*

[1] *When is the Best Time to Make a Lateral Move? Hugh A. Simons and Paola Cecchi-Dimeglio, The American Lawyer, 5 October 2017*

matters; sourcing work for each other; prospecting for new clients together; committing to continuous professional growth; and, taking on roles that help build the firm as both an operation and an institution. An effective comp system rewards such behaviors.

Other elements could be added to these three depending on a firm's strategic priorities at a particular point in time. For example, 'buckets' could be added for global teaming, innovation, etc. Accepting this three-bucket model for ease, then the next step in system design is to assign weightings to each bucket. The simplest way to think of this is to decide how much of a firm's profit pool should be allocated on each of these three bases. A typical allocation would be something like: 10-20 percent for ownership, 50-70 percent for profitability, and 20-40 percent for citizenship. The shares should be set as determined by a firm's strategic objectives. For example, a firm that is struggling to have partners develop profitable business might increase the portion allocated to profitability; a firm that is struggling to have its partners collaborate effectively might allocate more to citizenship.

An individual partner's comp would be the combination of allocations from each of these buckets. Determining how to allocate from each bucket to individual partners is thus the next step. The ownership bucket is perhaps the easiest as it is amenable to purely mechanical allocation. One could see this as in proportion to cumulative number of years as a partner, or on a ramp akin to lockstep, or as a percent of the sum of compensation over some prior period, or following how required capital contributions are determined.

The profitability bucket is more complex. It has to capture both origination and execution, and should be based not on revenues but on profitability. Many firms have been lax about how credit is shared between originating and executing partners. While it seems reasonable that the allocation to individual partners is something the partners themselves should determine, it is helpful if they can do so within a firm-sanctioned and transparent framework that prescribes norms for particular situations, e.g., for long-term client (where some of the credit goes to the long-ago originator of the relationship); new client; client ported by lateral partner, etc. For firms looking to encourage partners to collaborate more, it may make sense to, say, increase the credit available to 150 percent of actual if three or more partners share the work. The profit partners share is best measured using contribution margin, i.e., cash (or net revenues) less compensation costs for the all timekeepers (other than equity partners) involved. The timekeeper comp cost would be their hours times their annual comp converted to a per hour basis. Using just the comp cost focuses the profit definition on only the cost elements partners actually control, i.e., those associated with the time of lawyers of different seniorities required to deliver on the matter. To include allocations for costs partners don't control simply engenders frustration and acceptance of the methodology.

Allocation of the citizenship bucket is necessarily somewhat subjective. A key element is how partners are perceived by their peers. In principle, one could use a confidential rating of each partner by her peers as the basis for allocation. However, this approach tends to beget gaming. An approach I have seen be more effective is to let practice group and office leaders do the allocation based on integrating their own perspectives with confidential peer feedback. Partners would then be assigned a citizenship grade that is subject to a forced distribution curve (to avoid grade inflation). A super majority of partners would be in a single grade, with smaller numbers in higher or lower grades; each grade would have an associated allocation percent of the citizenship bucket associated with it.

A CLOSING THOUGHT

Addressing comp system design is one of those things that is important but never urgent. It's tempting to backburner it. This may not be wise. The coming turn of the business cycle will intensify partners' questioning of their firms' comp systems. It will be valuable to have robust answers. More positively, there is an upside to greater clarity: it requires no incremental profitability so that it is, in essence, a cost-free way to improve the level of partners' satisfaction with their comp. ■

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