Partner compensation and the new "value" reality

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Imagine this: The Managing Partner of one of the largest law firms in the country is looking around the conference table at 20 of his partners. The 20 partners are the firm's highest compensated partners, collectively earning nearly $60 million in each of the last three years. Somberly, the Managing Partner informs the group that he has concluded that the firm's compensation system, which has been in place for the past two decades, must be scrapped. They wait for him to explain how the new system will favor them so the group can continue to receive generous compensation. "The days of paying people based on gross revenue generation are over. From now on, compensation will be based on net profitability of work."

The likely outcome of this meeting: It would only be a matter of days before the Managing Partner is replaced, or some of your fellow partners start exploring their options at other firms.

This story only sounds apocryphal. Instead, this scene will play out as law firms are forced by the "changing economic dynamics" to restructure their business models into something that eliminates the focus on top-line revenue growth and client-insured profit. Instead, the focus on profit margins, lower cost production and results instead of hours and body count will fundamentally alter the way law firms measure, and reward, the value their lawyers deliver.

The first challenge is to eliminate the concepts of "lone wolf," "rainmaker" and other solitary figures from the firm psyche. Rhetoric notwithstanding, many firms have rewarded revenue generators so lavishly in comparison to the lawyers who do much of the work for the rainmaker's clients that they have fostered a "what's in it for me?" mentality on virtually every issue. Instead of looking first to the interests of clients, many partners first consider whether a course of conduct will provide career security or additional income. The significance of the problem is magnified by two factors: first, the senior partners most likely to be in a position to ask this question are the people most likely to be able to add value or decline to do so. Second, the problem is so pervasive that many partners don't even bother to ask for input from another partner. Any senior partner who challenges the system is a threat to every other senior and powerful partner -- a no-win scenario.

The result of this behavior is that no matter how large a firm might be, it is comprised of individual silos. The partner builds his or her team, but there rarely are multiple "star" partners working on the same matter, no matter how complicated. Are we really to believe that one senior partner does not benefit from working closely with another senior partner on matters? If we do not believe this to be true, it seems inescapable that the state of affairs is influenced primarily, if not entirely, by compensation schemes.

Standard "eat what you kill" compensation schemes also are unhealthy. No amount is ever "enough." Instead, "enough" is defined as "more than" somebody else or some other group. The amount of time spent tearing down "the other guy" or complaining about minor compensation differences is enormous and wasteful, and particularly offensive in light of the amounts partners, especially senior partners, are paid. Compensation systems should attempt to minimize or eliminate destructive behavior among partners. Firms where partners routinely collaborate invariably report that exceptional value is derived from these efforts.

The second challenge for law firms is to determine what kind of compensation system will encourage that collaboration.

In a smaller firm it always seems so much easier to imbue systems that encourage and reward collaboration. The best way to guarantee that the first question on everyone's mind is how can we get better results for this client (and hence for the firm) would be to remove the ability of any partner to influence his or her compensation by a course of behavior different than the collaborative behavior the firm sought to maximize. You can accomplish that by deciding to pay partners the same amount. This was called the "rising tide raises all boats equally" compensation system.

The result of this system can be extraordinary. There is no destructive internal competition. Partners not only do those things in their comfort zone, but also are eager to help colleagues, because helping colleagues improves performance, which improves profitability. Partners are eager to accept assistance for precisely the same reason. This feature also has the collateral benefit that no time is spent at year end figuring out who gets what. There is no weighing of the relative value of one person's contribution versus another's. Such conflicts are inherently counterproductive.

As your firm grows and new partners are added those new partners need not be paid the same as others. It is enough that there is a fixed ratio between one level and the next. So, for example, newly admitted partners with lesser experience may earn at a rate of 80% of the original partners.

In a larger firm, there may be three or perhaps four compensation bands. The criteria for movement from one to the next, in either direction, would have to be articulated specifically and transparently for each individual firm to reflect the nature of its practice and culture. The goal would be to avoid the kinds of small scale distinctions among partners that foster the petty and destructive feelings of jealousy that so interfere with cooperation and collaboration.

While not the same as the "corporate model" addressed in the first article in this series, this "banding" approach serves many of the same purposes. First, and foremost, it ties everyone's compensation to profitability of the enterprise. This result, move than any other single thing, puts people in the same boat. A fee system that rewards the firm's performance further enhances this notion of common sacrifice and common benefit.

The compensation banding approach is not new or revolutionary to the practice of law, but their application has been corrupted to the point where there are almost as many bands in some firms as there are partners. Firms have, intentionally or not, created classes of lower tier partners working to deliver profits that are transferred to that upper tier of partners invited to the conference table. The amount of "rainmaking" gross revenue generated separates those in the upper tier, but without regard to profit created by that work.

The banding approach does not directly eliminate the "free-agent-pay-me-more-or-I'll-shop-my-book-of-business" extortion that some individual lawyers practice. It does, however, minimize the influence of those inclined to play that game. Because the alternative fee model eliminates the value of armies of faceless associates and de-valued "income partners" (highly capable and hard working lawyers who just don't happen to have the primary client relationship) working by the hour on a matter, the body count of the team assigned to a matter is eliminated. Instead, the value from a fee standpoint comes from obtaining a result, and a small team of experienced attorneys will fare better. This puts more people in contact with the client and enhances the value of the team, which reduces the prominence of the individual. Clients who are getting better results from a firm's team are less likely to want to move to another firm, especially if that other firm is not using the same dynamic fee system.

Clients benefit from this system because the collaborative efforts of the partners will produce better, more cost effective results than the silo system now prevailing. Clients also will be able to more easily see through the marketing rubric because the most profitable firms will achieve that status because they are the most successful in achieving their client objectives.

These changes will not come easily if at all at most firms. The vested interests and power of the entrenched beneficiaries of the status quo will stand firm to thwart the changes needed, since the old guard are the ones most likely to be relative losers under the new system. The thinking is that they paid their dues to a system where this was the way compensation worked, and now it fairly should be their turn at the trough. But the cheese has been moved for everyone. It is a fact in today's law firm world that you get what you pay for. Designing a system based on economic alignment, results instead of hours and cooperation and collaboration rather than competition among partners will make for better law firms and more satisfied clients.